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Modern Business

An Introduction to Principles and Problems

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MODERN BUSINESS

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Preface

The function of a course in introduction to business is to describe and explain business in a general way and to show its relationship to society as a whole. The purpose is to present the social setting and the economic functioning of business rather than to make detailed and technical descriptions of business methods and procedures.

The number of topics that a course in introduction to business may include is almost limitless, and the problem of what to omit is almost as important as the question of what to include. In this book the authors have studiously avoided relatively unimportant details and have concentrated on presenting only such material as will serve the purpose of giving a general picture of business in its basic function of supplying the economic needs of society.

It has been assumed that the social purpose of business is to satisfy human needs, and the theme is developed in a logical sequence. Consideration is first given to the general machinery forming the basis for business as a whole. This is followed by showing how a business is started, how goods are made and sold, and how the proceeds of such sales are divided among those who participate in production. This leads to a discussion of consumption, or the manner in which people may spend their money. The book is concluded with a discussion of government regulation and the topic of business ethics.

Mindful of the fact that there is a considerable difference between the length of time devoted to this subject in the various schools, the authors have attempted to provide adequate flexibility in the assignment material. If use is made of all this material, enough work is provided for a full-year course. If a shorter course is desired, the textbook can still be completed by omitting a sufficient portion of the references and supplementary exercises.

In treating controversial economic and political questions, the authors aim to be descriptive rather than argumentative. They have not hesitated to point out the shortcomings of our prevailing business system, but, at the same time, due credit has been given to the real merits of such a system. It is the aim to present conditions as they really are, enlivened by a spirit of optimism and a keen sense of high ethical standards.

THE AUTHORS

CEDAR FALLS, IOWA
MINNEAPOLIS, MINN.
February, 1948

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Editor's Introduction

We tend to take our economic system for granted, to assume that it is perfect, and to resent criticisms of it. Too many people have but a superficial knowledge of what this system really is, how it has been developed over the years, and how it works. It is not enough to know, or to believe, that our economic system is best; it is equally important to know *why* it is so and *how* it got that way, lest the intelligent vigilance necessary to keep it superior and developing in the right direction be lacking. Our entire citizenry must be well informed, and it is of particular importance for those who expect to direct our business activities to understand our economic system.

There are many parts to the complex thing that we call our *economic system*. The one factor, however, that lies at the heart of the operation of the system is what we refer to as *business*. A number of books are available for courses that deal with business in general—its organization, principles, and practices. But many, if not most, of them are expressly concerned with the training of people to participate in business as workers or proprietors rather than with the education of people to understand the socio-economic function of business. This text, "Modern Business: An Introduction to Principles and Problems," presents business from the social-service point of view and aims to promote a better understanding of the part it plays in our economic system. At the same time the book provides a clear, comprehensive overview of business.

To be sure, there are bound to be differences of opinion about a thing as complex and far reaching in its impacts as is our business system. The authors of this book have striven for complete objectivity in the discussion of a business system in which they have a deep-seated faith. They have exercised care not to overlook weaknesses in our system while pointing out its inherent strength.

The text provides the basic training in organizational and administrative principles and procedures that everyone who contemplates a business career should have. The effective blending of

1. How does business operate?

PREVIEW: Different countries have various ways of providing goods and services for their people. Some economic systems are more or less self-sufficient, whereas others depend upon other countries to provide most of their needs. Some economic systems make use of hand tools as the means of furnishing the material necessities of life. In the United States we have an economy that is neither self-sufficient nor dependent upon simple hand tools. It is an interdependent economy characterized by mass production. Should we attempt to be more self-sufficient? Is an economic system of specialization and mass production socially and economically desirable?

WHY DO WE HAVE BUSINESS?

The institution known as *business* arises primarily from the fact that there is a multitude of human desires that can be satisfied only by means of goods and services produced by efforts wisely directed toward specific ends.

There is another reason why business is necessary. Each person does not produce all the goods and services he needs for himself. Instead each individual confines himself to a limited line of production with the expectation of exchanging the fruits of his efforts for other things that he may desire.

The things that we produce are not normally exchanged directly for other goods and services. We are paid in money, and we may use this money to purchase anything we choose that money will buy. We may therefore define business as consisting of *all human efforts directed toward the production and sale of goods and services for a monetary reward.* Doing things for ourselves or producing goods for ourselves may at times be important activities, but they do not come under the heading of business, since no exchange with others is involved.

ROBINSON CRUSOE HAD CERTAIN ADVANTAGES

It appears that Robinson Crusoe on his island was an efficient worker, but he was not a businessman. He produced goods for himself in any manner that his inclinations and the surrounding circumstances dictated. However, he did not produce for sale. He had no customers.

Robinson Crusoe escaped many problems and difficulties that afflict our economic system. He ran no risk of unemployment or insolvency. He did not have to face cutthroat competition or outright dishonesty. He had no problems in connection with labor organizations, government regulation, taxation, or red tape. Crusoe was indeed a free man on his lonely island.

CRUSOE ALSO HAD CERTAIN DISADVANTAGES

Notwithstanding all that is mentioned above, Crusoe did not lead an ideal economic existence. He suffered from at least two serious handicaps:

1. As a civilized human being, he found that many of his economic wants were not satisfied.
2. He lost the advantages of specialization.

Imagine yourself living on an island alone beside a sparkling stream surrounded by green meadows and majestic forests. Imagine further that you have the essential tools and implements, some chickens, a horse, and a cow or two. The stream abounds with fish. The forests are swarming with game. The climate provides a happy mingling of rain and sunshine. You have food, clothing, and shelter. But what about medical care and various forms of personal service? What about books, periodicals, and formal educational advantages? What about radios, automobiles, refrigerators, and the hundreds of other things that have come to be looked upon practically as necessities in our highly developed economic society?

SPECIALIZATION ESSENTIAL TO ECONOMIC PROGRESS

We mentioned above that Robinson Crusoe lacked the advantages of specialization. He was perforce a jack-of-all-trades and was probably a master of none. Furthermore he lacked many basic materials that he could have acquired had he been in a position to specialize in certain products and exchange these for things he needed.

A self-sustaining economic existence is usually referred to as *economic isolation.* Such isolation presents difficulties under any circumstances. In the case of a country densely populated with teeming millions, it becomes practically impossible. When applied to individuals, the situation becomes even more difficult. No one person has access even to all the things that are necessary for a bare existence. Usually a person's life depends upon being able to offer goods or services that are wanted by others. He is forced to become something of a specialist.

This specialization or division of labor is found to a limited extent even among the most backward nations. In fact it has been practiced ever since our remote ancestors devised the idea of exchange. The present intensive application of the plan is largely a development of the last 150 years.

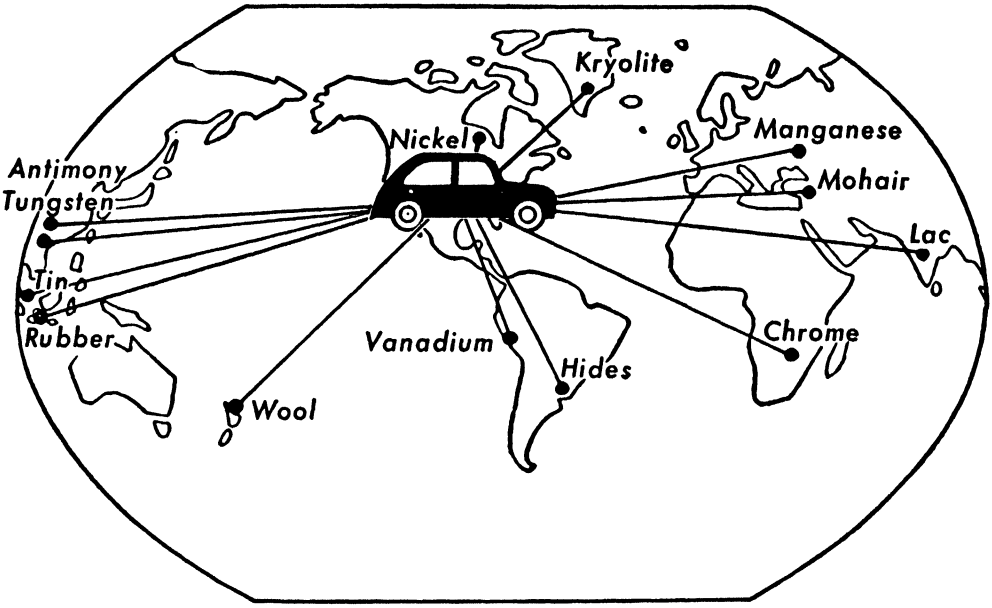
MASS PRODUCTION THE CLIMAX OF SPECIALIZATION

Specialization has found its culmination in what is known as *mass production.* Mass production is really nothing but specialized efforts scientifically directed toward producing a large and ever-increasing stream of goods. Gigantic factories employ workers in literally thousands of minutely specialized tasks. Materials and supplies are assembled from all parts of the globe. One single machine may do the tasks equivalent to those formerly performed by toiling thousands. The result is the general availability of comforts and luxuries undreamed of by kings in ages past.

Mass production has certain social disadvantages such as concentration of economic power and monotonous specialized tasks of workers, but the system delivers the goods.

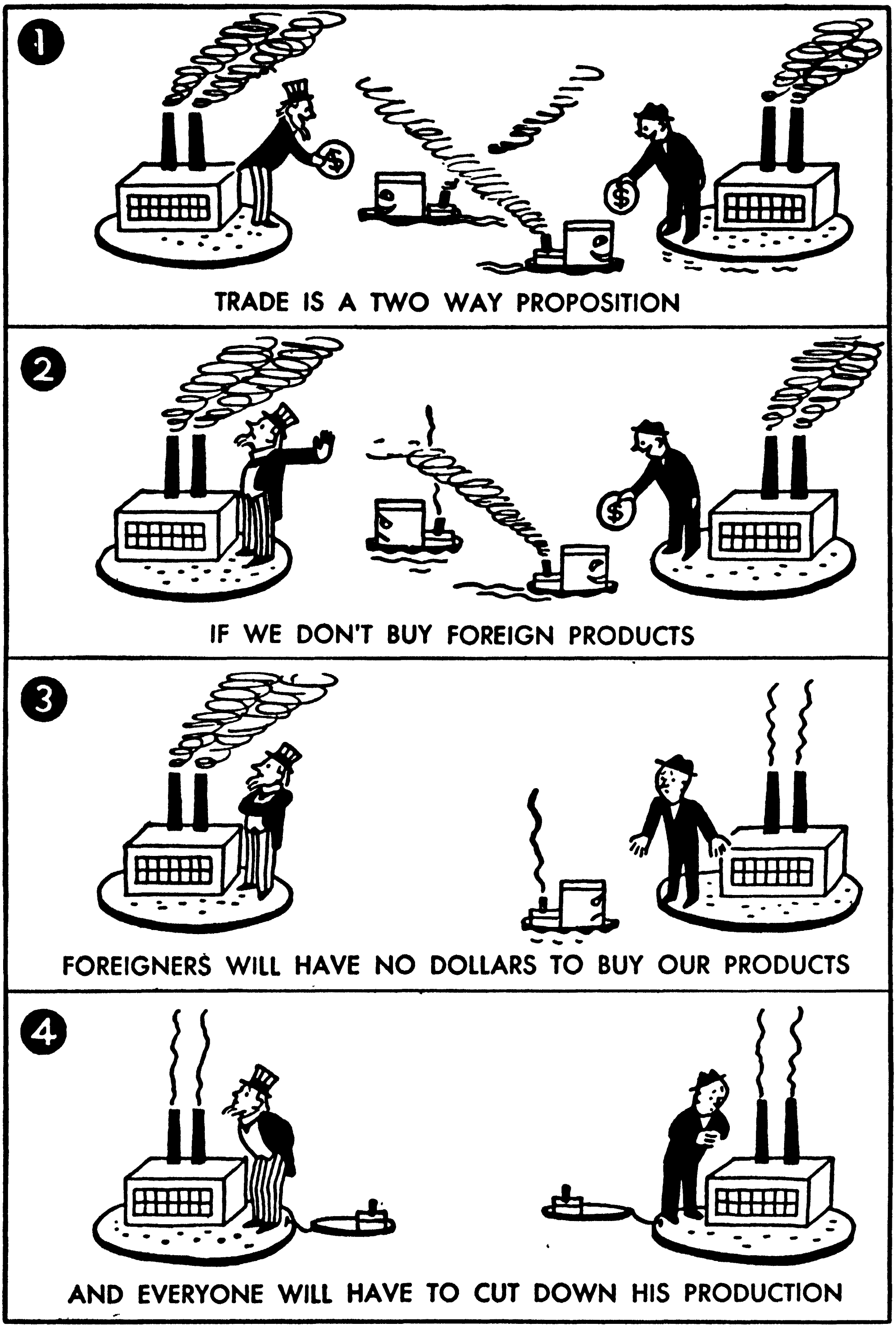
ECONOMIC ISOLATION MAY BE A RELATIVE TERM

It is a far cry from the idea of individual economic isolation to the other extreme view that would advocate perfectly unhampered trade on a world-wide scale. Most people believe in a policy somewhere between these extremes. It is not intended to argue the merits or demerits of these various views. It is important, however, to point out the existence of these different ideas and emphasize the need of establishing some kind of sensible and workable policies.



WHERE OUR AUTOMOBILES COME FROM. (Reproduced from "What Foreign Trade Means to You," by Maxwell S. Stewart, courtesy of the Public Affairs Committee, Inc., New York.)

The discussion of this question usually comes under the heading of *protection vs. free trade.* The purpose of protection is to give somehow the domestic producers an artificial advantage over importers of foreign goods. This may take the extreme form of an embargo on the import of certain commodities. Such a plan forbids the importation of such commodity. A more common method is to place a tax, called *duty,* on imports. Since the domestic producer is not required to pay this tax, he has, to that extent, an advantage over his foreign competitors. This tax is known as the *protective tariff.*


1
TRADE IS A TWO WAY PROPOSITION
2
IF WE DON'T BUY FOREIGN PRODUCTS
3
FOREIGNERS WILL HAVE NO DOLLARS TO BUY OUR PRODUCTS
4
AND EVERYONE WILL HAVE TO CUT DOWN HIS PRODUCTION

WHY PROTECTION DOES NOT PROTECT US. (Reproduced from "What Foreign Trade Means to You," by Maxwell S. Stewart, courtesy of the Public Affairs Committee, Inc., New York.)

Absolute freedom of trade would mean the abolishment of embargoes and protective tariffs. Logically it should also involve the removal of all restrictions against the free migration of capital and labor. If this plan were adopted, it would ultimately result in the fusion of the whole world into one economic unit. It would be a plan analogous to the one existing among the various states of our own country.

A condition of relative isolation springs chiefly from a desire to keep everything within one's own borders. The buy-at-home idea of local communities; the economic rivalries among states and regions; and the reluctance to permit the free inflow of foreign goods are all examples of desires to "protect the home market." From a short-run point of view, many of these situations may be defensible. Some protection for home markets may even be defended as a permanent policy. It must be admitted, however, that when carried to extremes they will in the long run approach a Crusoe policy of relative economic isolation.

DEGREE OF ISOLATION VARIES

The degree of desirable or even possible isolation differs with the human and natural resources of the community concerned. A country that lacks all but a few of the essentials depends upon foreign trade for its economic existence. A country that has a wide variety of products blended in proper proportion might possibly crawl into its metaphorical shell and let the rest of the world go by. We hasten to add that no country is quite in this position—not even our own. A good example of this is the predicament in which we found ourselves with respect to rubber, sugar, tin, tea, coffee, and numerous other commodities during the Second World War.

Before we leave this topic let us consider two concrete illustrations. The first example is that of a large island rich in certain minerals but almost void of everything else. There are no forests, no crops, no meadows. Nothing but a few hardy shrubs and occasionally a few venturesome flowers peek out from its stony slopes. This is a case where the import of most basic materials is vital and the import of many manufactured goods probably desirable.

On the other hand, let us take a country like our own. We have inventive genius and business talents perhaps excelling those of any other nation on the globe. We have 60 million workers with varied and happily proportioned skills for the thousands of specialized tasks that are to be performed. Notwithstanding all these advantages, the partial loss of foreign trade brings repercussions that are keenly felt in every home.

What are the reasons for this? In the first place, no country, not even our own, has *all* the basic materials. In many instances we are like a housewife who was baking a cake. She had all the ingredients except baking powder. In spite of her supply of flour, sugar, butter, and eggs, her cake was literally a failure.

Then again, there are some things we might produce but only at prohibitive costs. We have the same reason for trading with foreign nations that we have for trading with one another—it is more economical. With considerable time and effort one might be able to fashion a crude mousetrap, but it is more economical to pay a nickel for one at the store.

There is a third element in connection with foreign trade that is worthy of consideration. Business is built upon the basis of certain production patterns over a period of time. A sudden and all-inclusive effort to become nationally self-sustaining would wreck this pattern, causing serious maladjustments and economic misery for a considerable period of time. Certain of our industries, for instance, agriculture, are geared up to the expectation of a considerable export market. It takes but little reasoning to realize that if we are going to sell to foreign nations we must also be willing to buy from them. The departure from a policy that includes a considerable amount of foreign trade might cause economic difficulties for a generation. True enough, in the long run we might become adjusted to a different policy, but, as one economist aptly puts it, "In the long run we'll all be dead." The possibility that all will be well in 50 years is a dubious comfort to the present generation.

SUMMARY

An understanding of business involves a knowledge of the background underlying our business activities. For this reason the first two chapters of this book are devoted to a general discussion of economic theories and principles. The remaining portion of the book is concerned chiefly with a description of business as it actually operates.

Business consists of all human efforts directed toward the production and sale of goods for a monetary reward. Production alone is not business. It is only when goods are produced with a view to exchange that one can properly speak about business transactions. Such exchange is usually carried out by means of money.

The practice of trading with others has several advantages over economic isolation.

1. It provides each individual with a greater variety of goods and services.
2. It makes specialization possible and thus permits each person or each community to produce with a higher degree of efficiency.
3. It permits a great accumulation of labor and capital in one enterprise and thus facilitates the increase of goods resulting from mass production.
4. Thus there are more goods and services for people to use—a higher standard of living.

National economic isolation results in the loss of at least the first two of the above advantages. At best, determined efforts directed toward national self-sufficiency would cause an unfortunate disruption of existing business patterns.

QUESTIONS FOR REVIEW

1. What is the basic reason for business activity?
2. What other reason also is present?
3. What modern economic problems did Crusoe escape?
4. What relative disadvantages did Crusoe have?
5. Does specialization have any effect on the amount of goods produced?
6. Is economic isolation customary in thickly populated countries?
7. Are "division of labor" and "exchange" new ideas?
8. How is mass production related to division of labor?
9. What might be considered to be the extreme opposite of individual economic isolation?

10. Mention some ideas occasionally voiced that in the long run would tend to create relative economic isolation.
11. Give three main reasons why the degree of isolation varies from country to country.

TERMS AND PHRASES TO DEFINE OR EXPLAIN

1. Business
2. Monetary reward
3. Production for sale
4. Insolvency
5. Cutthroat competition
6. Red tape
7. Specialization
8. Division of labor
9. Mass production
10. Luxuries
11. Free trade
12. Prohibitive cost

QUESTIONS FOR DISCUSSION

1. Do human desires change? Give reasons for your answer.
2. Just why does specialization result in a greater total of goods for consumption?
3. Would it be possible to have specialization and mass production if no medium of exchange (money) were available? Explain your answer.
4. Can you think of any disadvantages accompanying mass production?
5. Inventive genius is important to mass production. Why has the United States always been a leader of nations in this respect?
6. Is foreign trade essential to the comfort and prosperity of a nation such as the United States today?
7. What is there about "profit" that makes it such a powerful motivation for individuals?
8. (*a*) What difficulties sometimes arise as a result of the profit motive?

   (*b*) Can anything be done about this without destroying the profit motive?
9. Do you see any relation between savings and mass production today?
10. Is a farmer engaged in business?

CASE PROBLEM

Hiram Thornbrook runs a general store in the little village of Gnawbone. He severely criticizes his neighbor, Ted Jones, because Mr. Jones frequently buys goods from (*a*) mail-order houses and (*b*) chain stores in the nearest city. He says, "Ted, you should keep your money here at home where it will do you more good. Those people don't help run our school and build our roads here at Gnawbone; they haven't any interest in your children and whether they grow up to be good citizens. Besides, it isn't fair to me to expect me to have the little items handy here when you want them and not give me enough of your business to make a living for myself." What do you think about it?

SUGGESTED PROJECTS

1. Prepare a list of names of 25 neighbors or adult acquaintances who are engaged in earning a living. Then decide which ones may be classified as being at least partially engaged in some type of "business" activity.
2. The official publication of the U.S. Chamber of Commerce is the *Nation's Business.* This may safely be assumed to represent the thinking of most businessmen and women. Consult recent issues of this publication or some other one suggested by your instructor and be prepared to report to the class what you find currently related to topics discussed in this chapter, such as economic isolation, foreign trade, free trade, specialization, etc. Report particularly on any articles, editorials, or comments that you consider of special interest or significance.

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2. What makes the wheels turn?

PREVIEW: Providing proper incentives and drives is essential to the successful operation of a business system. Our business system is based upon the assumption that free economic decisions, actions, and opportunities provide the best motivation for the production of goods and services. How free should our business system be? Should there be more regulation or less regulation? Should there be more economic planning?

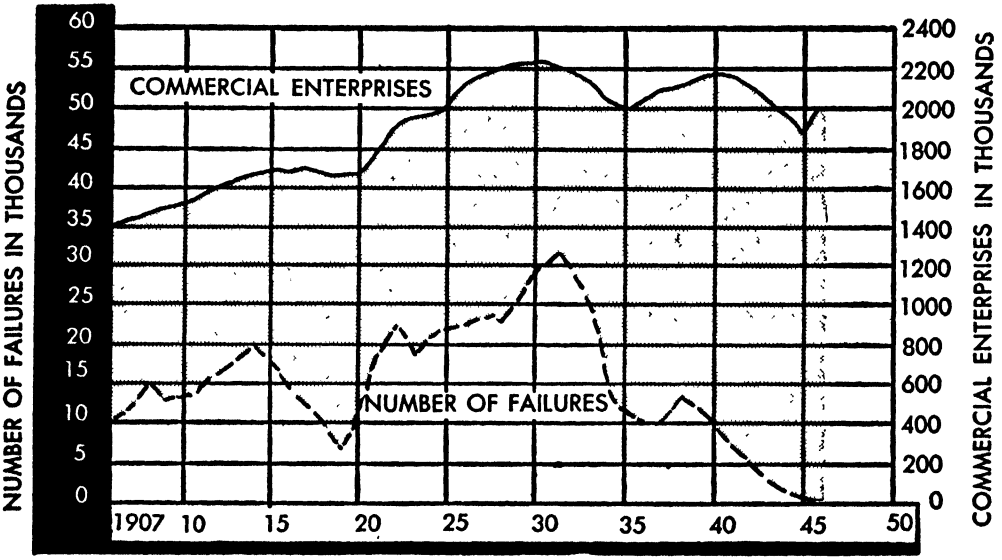
WHY DO MEN WORK?

Did you ever wake up on a cold, dismal morning wishing that your day's task did not lie before you? Perhaps you have not had that experience, but most people have. There is nothing unusual or alarming when you feel that way about the day before you. It is a part of human nature. This does not necessarily mean that one dislikes work. It merely means that people love leisure or the privilege of doing as they please.

The attitude toward work differs with different persons or with different occupations. Unfortunately some people look upon their jobs as necessary evils connected with making a living. Most people are not positively averse to their occupations but would prefer an independent income without being tied down to a specific job. Some people would rather work at their tasks than do anything else in the world. On the whole we can take it for granted that most people do not toil for the sheer love of the work. There must be some other form of either compulsion or motivation.

RISKS ARE TAKEN IN HOPES OF WINNING

The progress of modern business involves more than toil of brain and brawn—it includes taking chances. The men who initiated the building of our factories, the developing of our mines, the breaking of our virgin soil, and the connecting of the two oceans by means of a network of railways were more than workers—they were men who were willing to risk their efforts and their savings in the hopes of future monetary rewards. People will take chances, but few will voluntarily risk anything without hopes of some kind of gain.



COMMERCIAL ENTERPRISES AND THE NUMBER OF FAILURES IN THE UNITED STATES 1907–1946. (Data furnished by Dun & Bradstreet.)

It is fortunate that there are those who are willing to assume business risks. It is possible for people to lend money at from 2 to 4 per cent interest without much danger of losing either the interest or the principal. For people who are primarily interested in providing for future contingencies and old age, this is a wise procedure. On the other hand many have started with a few hundred dollars plus a good idea and made millions. We are sometimes inclined to be envious of such people. The reason for this is that we do not hear so much about the other side of the story—the tragic experience of people who risk large fortunes and lose. On the average, risk-taking may not be so profitable as it seems. If no one risked money on new ventures or on the expansion of old enterprises, there would be but little money lost, but also there would be little or no business progress. We have long known that "the laborer is worthy of his hire," but so also are those pioneers of industry who risk their labor, time, and money on business expansion.

*Commercial and Industrial Failures in the United States**

Year	*Number*	*Amount*
1907	11,725	$197,386,000
1912	15,452	203,118,000
1917	13,855	182,441,000
1922	23,676	623,895,000
1927	23,146	520,105,000
1932†	31,822	928,313,000
1937	9,490	183,253,000
1938	12,836	246,505,000
1939	14,768	182,650,000
1940	13,619	166,684,000
1941	11,848	136,104,000
1942	9,405	100,763,000
1943	3,221	45,339,000
1944	1,222	31,660,000
1945	810	30,395,000
1946	1,130	70,349,000

* These data do not include bank failures. "Failure" is here interpreted to mean a court procedure or voluntary action likely to result in loss to creditors.

† The largest number and the largest amount on record.

Business Failures Are Numerous under Competition and Freedom of Enterprise. Fluctuating World Economic Conditions Are Closely Related to Risk of Business Failure.

PRODUCTION POSSIBLE ONLY IF WE WORK AND VENTURE

We now come to the crux of the whole problem. We want products in the form of goods and services, but most of these things are not to be had without work and risk. Since working and risking do not usually provide their own reward, we must do something in order to induce a sufficient number of people to put forth an adequate amount of effort, skill, ingenuity, and enterprise to make a reasonably satisfactory amount of production possible.

A person may have too much of a few particular things, but the economic desires in general are insatiable. Extremely few people have all they want of everything. We therefore have on one hand the unlimited desire for products; on the other hand we have the fact of limited production. How are we going to bridge the gap at least partially? We must produce. But production is more or less irksome. Again it all resolves itself down to the question of motivation.

SLAVERY WAS ONE SOLUTION

We do not know when slavery originated upon the earth. We can, however, imagine that one day some unscrupulous but enterprising fellow conceived the idea of supplying some of his needs by compelling others to work for him. The result was not a clear gain for the entrepreneur. He had to supply his slaves with enough of the necessities of life to keep them in working condition and make it possible for them to reproduce their ever-dwindling ranks. It must be admitted that it was one way of motivating production. However, as a system conducive to economic progress, slavery was a failure. The slave could never hope to get beyond a subsistence level. The master, possessed of an abundance of cheap labor, had little incentive to introduce laborsaving devices.

Serfdom in the Middle Ages was but a slight improvement over slavery. The serf had certain freedoms not possessed by the slaves, but he was bound to his plot of soil and existed primarily for the benefit of his feudal lord. Conditions resembling serfdom and slavery still exist in some parts of the world. The system as a recognized institution has, however, been abolished in practically all parts of the civilized world.

TWO ALTERNATIVES REMAIN

Now, since we have abolished physical compulsion, how is production to be motivated? There must be some way of inducing people to work and to risk their resources, or there will be no production. At this point we should remember that we are referring to an exchange economy. If each person, like Robinson Crusoe, attempted to supply all his own needs, the motivating force would, of course, be the prevention of starvation and other privations.

The two possible systems may be broadly designated as *free enterprise* on one hand, or *regimentation* and *rationing* on the other. Under a free-enterprise system each individual is largely left free to engage in whatever occupation he desires, and the resulting income may be spent as he chooses. If the plan of regimentation and rationing is employed, the proper governmental authorities put limits upon particular things that people may buy and will also designate the work that each person may do. In other words it is an *all-out planned economy.*

Let us look more closely at these two methods, beginning with regimentation and rationing.

THE FAMILY AN EXAMPLE OF PLANNED ECONOMY

The statement, "We are just like one big happy family," is an apt expression. Among other things it means that there is not much argument about the allocation of tasks and the distribution of income. Work is assigned on the basis of some more or less arbitrary plan. The family income is distributed according to need or circumstances. This is planned economy.

There is reason to suspect that this plan works out better in a family than it would in a larger community. Nevertheless we find that even within the home circle the system to some extent breaks down. Father frequently likes to have some money that he may call distinctly his own. Mother commonly has an allowance, and the same privilege is frequently extended to the children to cover a portion of their expenses.

Even our much lauded happy family may sometimes chafe under too much rationing and regimentation.

ALL PLANNED ECONOMIES FUNDAMENTALLY ALIKE

Even a brief explanation of the various types of planned economies would fill a volume of considerable size. There is a considerable difference among the detailed workings of planned economies and there may also be some variations in their specific objectives. However, they all have one basic thing in common—they depend upon governmental control for the attainment of their goals rather than upon the free choice of individuals.

What are the advantages and disadvantages? The chief merits claimed for the various types of planned economy are that they bring about a more orderly system of production, facilitate a more equitable distribution of wealth, and make better provisions for the minimum of individual security. The chief disadvantages pointed out by opponents of a planned economy are that it hampers progress, destroys individual freedom and initiative, and, in the long run, may create new problems rather than solving the old. It is further claimed that a planned economy must rest largely upon the judgment of a few men. This last reason alone inspires many people with an uneasy feeling that such a system just wouldn't work in the long run.

In addition to the alleged economic disadvantages of an all-out planned economy, there may be certain social and political disadvantages. For instance, democracy is not conducive to the successful operation of such a system. Democracy would be a case of too many cooks spoiling the broth. Planning means centralization of authority, and it is claimed with a high degree of plausibility that centralization leads to dictatorship. This is a point well worth considering. Even if a planned economy worked out advantageously from an economic standpoint, it might still be socially undesirable. Many feel that the cost of this kind of economic security is too high if it must be purchased at the price of individual freedom.

THE FREE-ENTERPRISE SYSTEM IS LARGELY AUTOMATIC

In 1776, Adam Smith, an English economist, published a book entitled the "Wealth of Nations" ("An Inquiry into the Nature and Causes of the Wealth of Nations"). Smith's propositions were not entirely original, neither should we assume that what he advocated was entirely unknown in contemporary business practice. However, he clarified many things that most people at the time saw but dimly and organized a number of isolated ideas into a systematic whole.

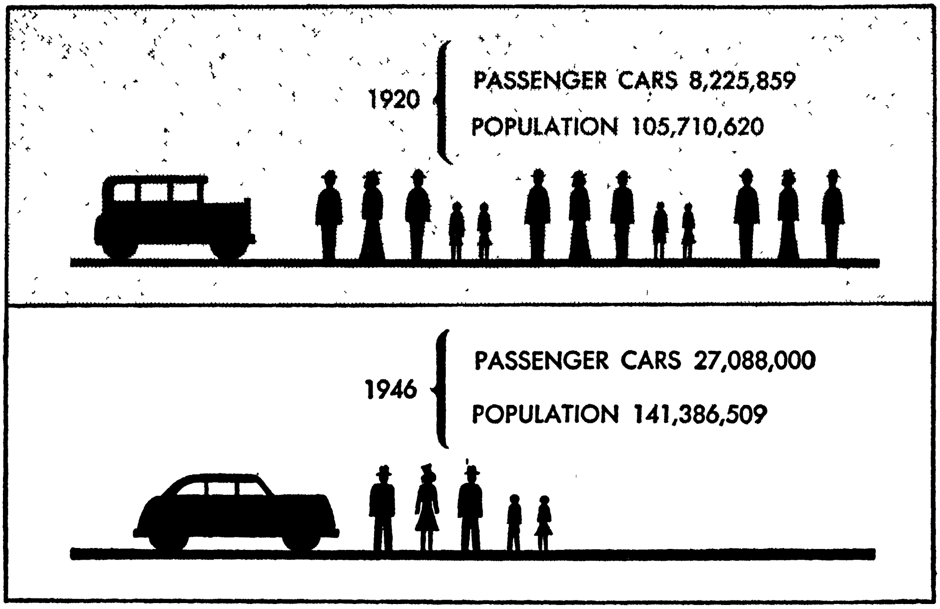
Smith wrote of many things, but the portion of his writings that is pertinent to our present discussion may be stated as follows: If each person in the economic society is left free to seek his own personal interests in matters of production and exchange, he will be guided as "if by an invisible hand" to do that which best promotes the welfare of society.

Smith's basic idea seems convincing to many people both from a logical standpoint and on the basis of experience. It is claimed by advocates of free enterprise that individual self-seeking will contribute to the public good. Success in business largely depends upon the abiding good will of potential customers. Free business enterprise attempts to produce what people want at as low a price as is consistent with adequate quality. Producing in competition with others who are also trying to please the consumer provides for the public welfare. Over a short period of time some people have, unfortunately, succeeded in making fortunes by means of unscrupulous dealings. However, these instances are exceptions to the general rule. In general, permanent business can be built up only on the bases of productive efficiency, integrity, and a scrupulous regard for the public good. These are the points of view of the supporters of free enterprise.

EXPERIENCE CONFIRMS THE THEORY

Proponents of free enterprise point out that a decade now under the competitive system marks more economic progress than was achieved in a century in ages past. Measured in reliable quantitative terms, it could probably be proved that the economic welfare of the masses has at least doubled during the last hundred years.

Specifically, how is it claimed that this progress comes about? The automobile is a common illustration of how the competitive system operates to the advantage of the many. At the beginning of this century, automobiles, such as they were, appeared at infrequent intervals upon our streets and inferior highways. The "horseless carriages" were the prized possessions of a favored few. A young man by the name of Henry Ford conceived the idea of producing a motor vehicle that would be within the financial reach of the millions. Mr. Ford may have had a combination of motives for bringing out his famous Model T. Be that as it may, it does not in the least detract from Henry Ford's reputation to assume that the dominating motive was to earn some well-deserved dollars for himself. Soon other manufacturers took up the challenge. A veritable race got under way to provide excellent automobiles at an ever-decreasing cost. The result was that by 1935 we had 30 million motor vehicles spinning over the dense network of excellent highways that now span our country from coast to coast.



RELATIONSHIP OF THE NUMBER OF PASSENGER CARS IN THE UNITED STATES TO THE POPULATION, 1920 AND 1946.

Annual Production of Automobiles in the United States

Year	*Number Produced*
1900	4,192
1905	25,000
1910	187,000
1915	969,930
1920	2,227,349
1925	4,265,830
1930	3,355,986
1935	3,946,934
1940	4,469,354
1941*	4,838,561

SOURCE: Automobile Manufacturers Association.
* Data restricted during later years due to war.

Mass-production Techniques Readily Supply Huge Consumer Demands and Usually at Lower Prices.

Now what is the point in this story? The automobile manufacturers were not necessarily altruists; neither were they spurred on by "planned economy." No, rather it is true that "in pursuing their own personal interests they were led as if by an 'invisible hand' to do that which best served the economic interest of society."

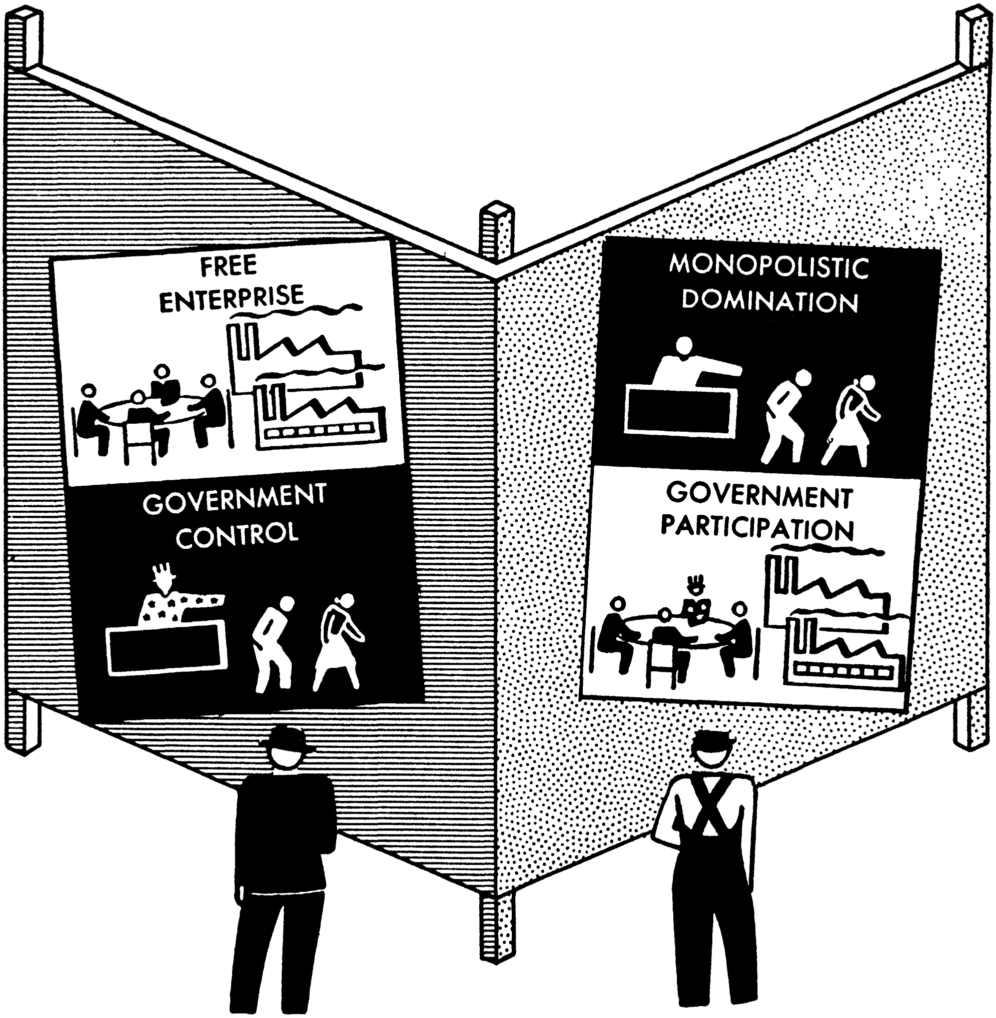
Some critics of this view of our capitalistic system contend that this is not a realistic conception. They maintain that today the idea of a wholly automatic system propelled by the profit motive is not acceptable. Forward-looking businessmen are giving greater attention to their responsibility to public interest and welfare.

REGULATION NOT SAME AS REGIMENTATION

When laws are passed restricting or forbidding certain business practices, we frequently hear the cry of regimentation. This complaint may or may not be justified. The fact of the matter is that countries enjoying free enterprise must sometimes resort to something closely resembling partial regimentation—this is especially true in times of a national emergency. Good examples of this are priorities, rationing, price controls, etc., during the Second World War. On the other hand countries working under a planned economy may permit a limited amount of individual industrial freedom. The difference is chiefly one of emphasis and objectives. The planned economy relies basically upon regimentation and rationing for the achievement of its goal and permits individual enterprise only to the extent that it seems to fit in with the *plan.* Free enterprise relies fundamentally upon free individual choice but yet resorts to such governmental measures as seem necessary for the smooth operation of the competitive system in its function of rather automatically promoting the general welfare. Examples of such regulatory measures are laws to curb or regulate monopolies, prevent swindles, provide greater equality of opportunities, stabilize business, and provide a certain measure of social security.

REGULATION NECESSARY

Laws regulating business are not the same as regimentation. Some of these rules exist solely for the purpose of facilitating business transactions among individuals. In other words they are the rules of procedure. Other laws are introduced to regulate business broadly as a whole. Such regulations set up the government as an



IT ALL DEPENDS ON THE POINT OF VIEW. (Reproduced from "The American Way—Business Freedom or Government Control?" by Maxwell S. Stewart, courtesy of the Public Affairs Committee, Inc., New York.)

umpire to assure us that the processes of free enterprise will be carried out in a manner beneficial to the public good.

The degree of success with priorities, price control, rationing, and business allocations in times of war should not lead us to the conclusion that the same restrictions would advance the public good in times of peace. These restrictions are generally considered as necessary inconveniences during war. In times of peace the public would probably be reluctant to accept these restrictions. In normal times the appeal to patriotism is largely lacking, and the emergencies that made the wartime regulations necessary no longer exist. We need price controls and rationing in war because of fear of inflation, and because such a large portion of our productive resources are devoted to war that there is no way of increasing the limited supply of civilian goods. We need priorities and allocations because otherwise it might be that an insufficient amount of our productive capacity would be turned to war production. In peacetime we leave most of these matters to be adjusted by demand and supply operating through the price system.

CHARACTERISTICS OF A SYSTEM OF PRIVATE ENTERPRISE

Freedom is the watchword of a system of private enterprise. Freedom of the individual and freedom of enterprise, as provided by law, constitute the essentials of a system of free enterprise.

Free economic choices. Individuals should be free to make their own decisions regarding economic matters. A man is free to rent or buy a business; to work or not to work; to lend his money or not; to buy some things and not others; and to employ laborers or not. The right to free economic choices must then be safeguarded if a system of private enterprise is to be maintained.

The right of free economic choices also involves freedom to enter and withdraw from business at will and to make decisions regarding what and how a product shall be produced and how the product shall be distributed. Of course certain existing regulations do not permit absolute freedom. If permitted to run riot, a system of free enterprise would certainly imperil both the system and the public good. The right to enter and withdraw from certain types of business enterprise, such as public utilities, is not permitted by law. Decisions regarding hours of work, sanitary and safety conditions under which work is done, and wages are to some extent governed by law. Even so the majority of the decisions in a system of free enterprise are essentially free from any restraining control.

Private property. The right to private ownership of property is a second essential of a free-enterprise system. Again certain legal safeguards prevent complete freedom of action with respect to private property. Legal restrictions prevent persons from taking over the property belonging to others. Owners of property are also prevented from using this freedom as a means of injuring others. The freedom of private ownership of property is a right extended to all in a system of free enterprise.

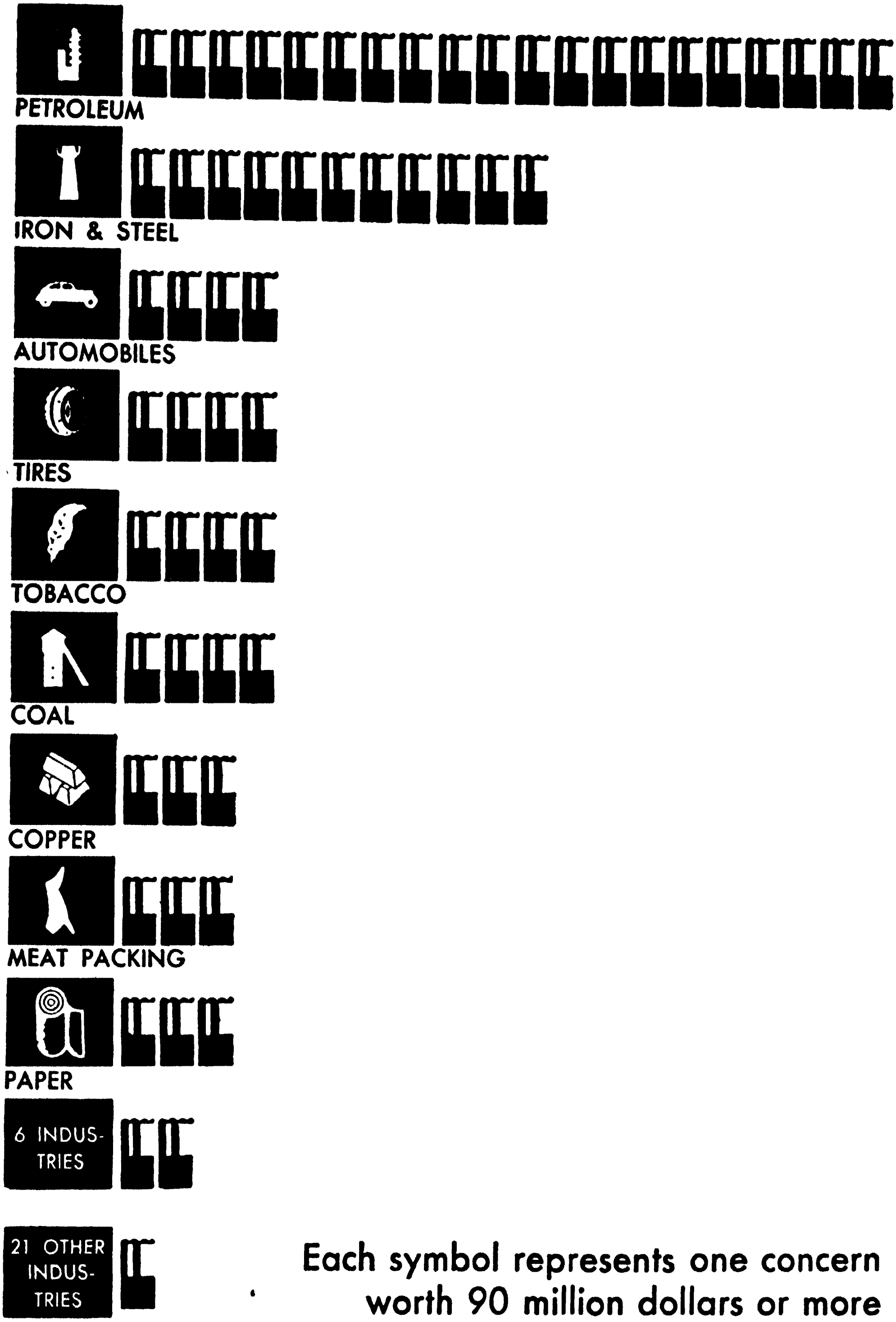
Freedom of contract. Freedom of contract is a third essential of a free-enterprise system. The right to make contracts is highly significant. Contracts constitute an agreement for mutual exchange. Without such freedom a private system of free enterprise could not operate. Government again plays an important role in connection with this important business instrument, the contract. The government provides the framework essential to the enforcement of contracts. Contractual business relationships would be of little significance if proper means of enforcement were not present.

Freedom of competition. Freedom to compete is the fourth essential characteristic of a free-enterprise system. In fact freedom of competition is the characteristic most often associated with the private-enterprise system. Rivalry between businessmen for the consumer's dollar is considered the essence of a free private-enterprise system. Absolute freedom to compete would involve certain practices that would be socially undesirable. The government again steps in to set up certain rules of fair play to protect the consumer as well as honest businessmen. Misrepresentation, fraud, collusion, and similar practices are considered illegal competitive devices.

So our system of free enterprise is not entirely free to the extent that anyone may do just as he pleases. There are restrictions, some of which were pointed out above; others not mentioned are also designed for the common good.

THE IMPORTANCE OF THE CONSUMER IN A FREE-ENTERPRISE SYSTEM

A business system that promotes free economic choices places a grave responsibility in the hands of the consumer. With his dollars the consumer directs the economic resources of the country. If his choices of goods and services are intelligent, he contributes to the general well-being of the nation. If, however, the consumer is not



COMPETITION BY GIANT CONCERNS IN MAJOR INDUSTRIES. (Reproduced from "Industrial Price Policies," by Maxwell S. Stewart, courtesy of the Public Affairs Committee, Inc., New York.)

competent to judge what is best for himself and the public in general he is responsible for guiding the productive resources into undesirable channels. Intelligent action by informed consumers therefore is imperative for the survival of a free-enterprise system.

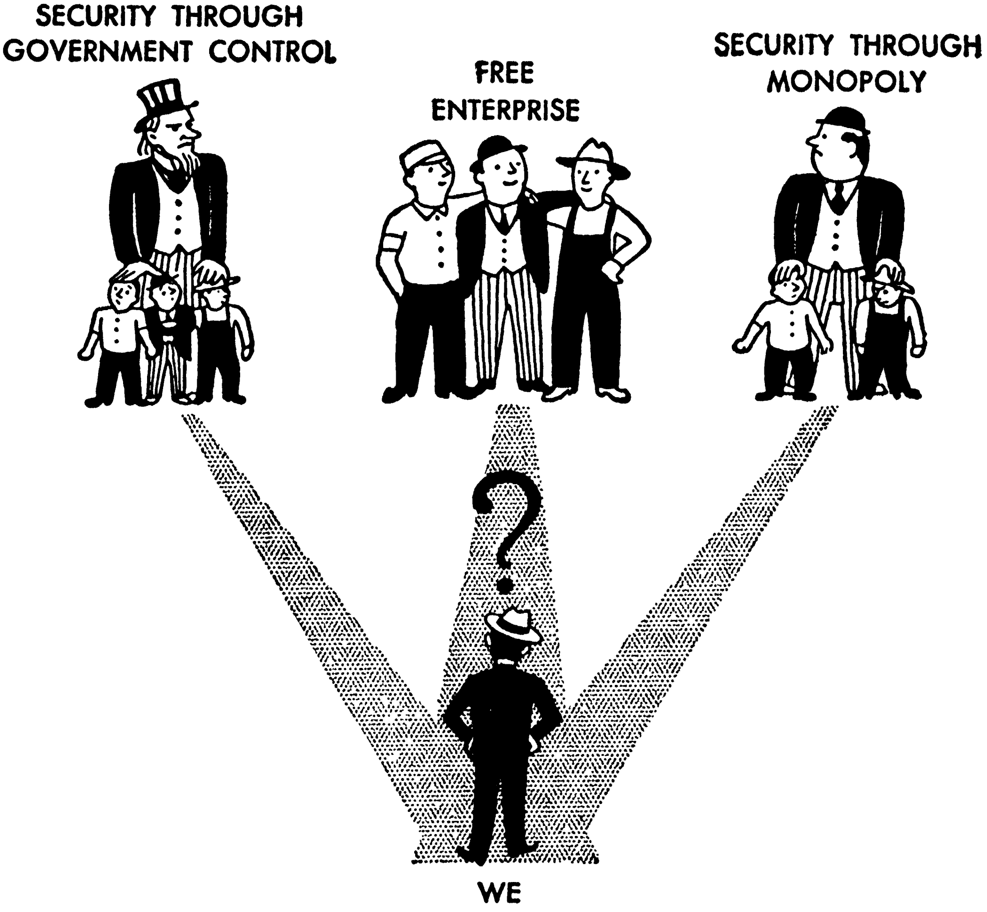
It is assumed that through competition between businessmen the best interests of the consumer are served. If one businessman attempts to sell an inferior product at a higher price than others, his competitors will force him to go out of business or lower the price. This assumption is true only when the parties involved (both the producer and the consumer) are equally strong and informed. If the consumer is not equal to the seller in ability to discriminate accurately, the welfare of the consumer may not be maintained. The effectiveness of free competition depends upon the competence of the consumer to judge accurately the best quality at lowest price and to seek out the ethical and honest sellers. Through consumer ignorance and carelessness, undesirable social and economic practices may be encouraged.

Intelligent consumer action is an important safeguard to the interests of the general public and to the welfare of honest and efficient sellers. The responsibility for the direction of the "invisible hand" that guides business enterprise in the direction of the welfare of society lies with the consumer.

THE COMPETITIVE SYSTEM IS NOT PERFECT

Once we went on a long trip, driving a reasonably good car. Everything about the car went wrong on the way. We had two punctures and one blowout; the muffler went wrong and had to be replaced; the body developed an unearthly and unfathomable squeak. To cap the climax, we inadvertently ran into a telephone pole, bent the bumper, smashed a fender, and knocked off a headlight. By that time we were exasperated and vowed we would sell the wreck to the nearest junk dealer. Naturally when we regained our usual emotional stability, we decided to repair the automobile and keep it. It was a pretty good old car at that.

It is very much the same with our free, competitive, capitalistic economy. We sometimes become impatient with some of its failings. There seem to be maladjustments and inequities in the distribution of wealth; there are periods of feverish prosperity followed by business stagnations and depressions; in too many instances the system results in a lack of economic security for certain individuals; its advertising and selling methods sometimes range all the way from skillful and refined deception to plain, unadulterated bunk.


SECURITY THROUGH GOVERNMENT CONTROL
FREE ENTERPRISE
SECURITY THROUGH MONOPOLY
?
WE

THE ROAD AHEAD. (Reproduced from "Cartels or Free Enterprise," by Thurman W. Arnold, courtesy of the Public Affairs Committee, Inc., New York.)

In view of these circumstances it is not surprising that some people at times become exasperated and feel like making a deal with an available purveyor of some kind of planned economy. However, when they regain their emotional stability, many of them decide it is better to repair and improve the system and keep it. They conclude that it is a pretty good old system at that.

A system that, on the whole, has produced a greater increase in general economic prosperity in 200 years than was achieved during the previous 2,000 years is not to be lightly discarded. However, with the trend in many countries toward more objective planning, this influence is being felt in the United States.

PLANNING IN A FREE-ENTERPRISE SYSTEM

From the preceding discussion one may get the impression that a free-enterprise system is a haphazard, do-as-you-please procedure. Such is not entirely the case. As pointed out, there is evidence of uncoordinated activities of individual business units that often result in waste of manpower and materials. However, a certain amount of planning does go on in a free-enterprise system.

Individual planning. A business system that requires a large outlay of money for the purchase of raw materials, buildings, machinery, and employment of workers in anticipation of production for future profit involves planning. Every businessman plans—the crossroads grocer and the president of a large corporation must plan. The amount of planning involved depends upon the type and size of the business.

In a later section the use of a planning procedure by management will be discussed. Problems of the purchase of new machines, the expansion or contraction of production, the manufacture of new products, the location of a plant, the comparison of expenses of a selling campaign with income all require careful planning if a business is to operate successfully.

Group planning. Trade associations and other business organizations are good examples of group planning by business. The National Association of Manufacturers and the U.S. Chamber of Commerce represent two large associations of businessmen who get together and plan for the future.

Trade associations carry on research programs with respect to production and distribution costs, rate of production, sales, prices, etc., within the industry. Such information is freely disseminated among the members of the association.

These associations of businessmen have also been accused of conspiring against the public welfare. Through various agreements and other tactics, trade associations may control competition. Undoubtedly some of these groups have been guilty of controlling both prices and production. However, in many instances their activities have resulted in valuable aid and guidance to management in wisely planning the efficient operation of their business.

Government and planning. Government agencies work with various business groups in an effort better to coordinate their activities. The Department of Commerce is a Federal government agency whose primary function is that of helping business plan more intelligently.

There are those who believe that there is a place for some system of over-all national democratic planning within the free-enterprise system. Such voluntary democratic planning would be provided through some kind of national economic planning board that would serve as a fact-finding and advisory commission. The function of this planning agency would be to study our economic ills and make recommendations to the government, employee groups, business associations, and consumer organizations.

There are many methods of planning. Planning in itself does not necessarily mean a regimented economy. Democratic planning and cooperation between interested groups within our free-enterprise system, to provide the stability and security desired by all, is a desirable goal toward which to work. In all this the value of the incentive and driving force provided by the free play of economic choices and the profit motive must not be minimized.

SUMMARY

Work and the assumption of risk are essential to production. In order to bring these factors into operation it is necessary to provide some form of motivation, since most men will not work for the sheer love of working.

Slavery was at one time considered a way out of the difficulty. This system was not satisfactory, since it did not provide a desirable way of life for the masses. Furthermore it retarded progress, since it tended to make the master indolent, unimaginative, and reactionary. As a recognized institution, slavery has now been abolished in practically all parts of the civilized world.

The economic systems now operating may be broadly divided into two groups:

1. Regimentation and rationing, sometimes referred to as *planned economy*
2. Free enterprise operating through the competitive capitalistic system

Planned economy may assume a variety of forms, but all have one thing in common—they are based on the idea of relying essentially upon governmental authority for the direction of production, distribution, and consumption. Some room may be allowed for private initiative, but only to the extent that it fits into the general framework of governmental direction and planning.

Free enterprise relies primarily upon free private choice and initiative. It operates on the premise that if each person is left free to seek his own economic good, society as a whole will be the final beneficiary. Free enterprise does not exclude a certain amount of governmental regulation, and in times of great emergency something resembling regimentation and rationing may be approached. However, free individual initiative is the basic motivation. This is interfered with only to the extent that it seems necessary in order to lead individual efforts into socially desirable channels.

The consumer assumes a very important role in a system of free enterprise. Intelligent consumer action can help to improve the economic well-being of society.

There is evidence of democratic planning within the free-enterprise system. There are some who believe there is need for additional voluntary cooperation to bring about greater economic stability within the framework of our free capitalistic system.

QUESTIONS FOR REVIEW

1. Why do most people work?
2. Mention some risks that businessmen frequently must take. Why do they take these risks?
3. Are we ever likely to produce more than we might *desire?*
4. Why was slavery ever started? What hopes did it hold for the economic status of the masses of slaves? What incentive was lacking for the master?
5. In general, how did a serf differ from a slave?
6. In an exchange economy, such as the world knows today, what two alternatives remain since slavery has been abolished?

7. Which of these systems is represented by the typical family economy? How does it work out? Would it likely work as well for an entire nation?
8. Give several illustrations of planned economies in operation today. In what fundamental way are they all similar?
9. What are the chief advantages claimed for a planned economy?
10. What are the chief disadvantages that may be pointed out?
11. Why may Adam Smith be regarded as "the father of the modern capitalistic, competitive economic philosophy based on free enterprise"?
12. Why is it that when one is left free to seek his own personal interests economically he will tend to do that which best promotes the welfare of society?
13. Has the free competitive system been sufficiently tried to arrive at a judgment about it yet?
14. Why did Henry Ford start making automobiles? Who has profited more, auto makers or the people of the United States?
15. Differentiate between regulation and regimentation.
16. Give illustrations of weaknesses recognized in the competitive system. Does this indicate that the system should be scrapped?
17. Distinguish between planning and a planned economy.

TERMS AND PHRASES TO DEFINE OR EXPLAIN

1. Slavery
2. Serfdom
3. Feudal lord
4. Incentive
5. Free individual initiative
6. Free competitive enterprise
7. Regimentation
8. Rationing
9. Planned economy
10. "Wealth of Nations"
11. Capitalistic economy
12. Distribution of wealth

QUESTIONS FOR DISCUSSION

1. Is there any business that is a "sure thing"?
2. Discuss this statement: "Work provides its own reward."
3. Is there a motivation behind all work?
4. Do you think slavery could be made to work as an economic system, ignoring the social problems involved? Explain your answer.
5. What was the real motivating force behind work that Robinson Crusoe did? To what extent is this true of United States citizens today?
6. In what way may some of the planned economies of today over-

come weaknesses of the free competitive system? In doing this, what disadvantages probably would arise?

7. In the case of a planned economy, who does the planning? If it were in a democracy, would this mean that the answer would be different?
8. Under free competition, individuals have been known to do many types of things definitely harmful to society. Does this prove that Adam Smith was wrong in his philosophy?
9. Why is some regulation desirable under free individual competition?
10. Is it desirable that everyone should participate equally in the wealth or income of a nation?
11. What kind of planning might a national economic planning board do in the United States?

CASE PROBLEM

A soapbox orator in Hobo Square was heard to make the following statement: "The profit motive is selfish and as such is a relic of the Middle Ages. We have today learned that we have a brotherhood of common interests. But the capitalist rides roughshod over the interests of you and me while he becomes fabulously wealthy off our miseries. We must overthrow this selfish rule for profit of the few and set up a democratically planned and controlled rule to assure equality of opportunity for all. We must substitute the interest of the common man for the profit motive which heretofore has controlled our government."

How would you evaluate this statement?

SUGGESTED PROJECTS

1. Consult recent issues of the magazine *Fortune,* or some other magazine recommended by your instructor, and be prepared to summarize one or more articles indicating either strength or weakness for either regimentation (planned economy) or free enterprise.
2. Report on some interesting incident or fact connected with the lifework of some outstanding "captain of industry," business executive, or other business leader. If possible select this from the earlier history of business activities in the United States.
3. Consult "Wealth of Nations," by Adam Smith, and report on the main topics or chapters therein. Select one that interests you and report in detail on it.
4. Consult an economic history or other book of this nature, or an

encyclopedia, and report on the characteristics of the feudal system.

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Unit Two • PROVIDING THE GENERAL MACHINERY

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3. The rules of procedure

PREVIEW: In any society rules of conduct are necessary. Order is obtained in the complex operation of a society because of certain necessary rules of conduct that are accepted and observed by most of the people. Many controls operate to regulate the conduct of society. The strongest of these social controls is law. These social controls are provided for both the businessman and the consumer. What is the legal basis that provides for these essential rules of conduct in the United States?

LAW AROSE CHIEFLY FROM SOCIAL NECESSITY

Many thousands of years ago certain shepherds in the valleys of Asia got into a dispute about some pasture land. They left the question to be settled by a wise old man in their tribe. The old man did not know it, but, by settling the case the way he did, he became the father of real-estate laws and our modern intricate systems of courts and other tribunals. Other developments followed. Solemn covenants were made and enforced. Damages were awarded to people who had been wronged. Criminals were hunted down and punished. The age of law and order had begun.

Some laws may have originated as efforts by the strong to suppress the weak. However, law has arisen chiefly from social necessity. Such law is based upon reason and justice and aims primarily to correct wrongs and to deprive the wrongdoer of what he may have gained by his wrongful deeds. Another purpose of law is to discourage unlawful practice before it is attempted. At times the law may not always seem just. The reason for this is that the law of the courts is a human institution administered by fallible men. These exceptional instances do not negate the lofty purposes of our legal institutions, and it will generally be found that, if one does that which is just and reasonable, he is well within the law.

Law may be defined as rules and regulations enforced by competent authority whereby courts are governed in the administration of justice. Note from this definition that laws are applied through the courts and that these decisions are enforced by competent authority. This means that an individual is not permitted to take the law into his own hands. At times this might seem like the speediest and surest way to justice. Such a practice obviously would practically nullify the law and would lead to social chaos.

HOW OUR GOVERNMENT FUNCTIONS

Our laws derive their origin, interpretation, and enforcement from the various governmental institutions. In that connection there are two points that we should especially keep in mind:

1. We are governed partly by the Federal government and partly by the governments of the various states. It is important for a businessman, as well as for everyone else, to know to which he is responsible in connection with a given transaction.
2. Our governments, state and national, are divided on a functional basis into legislative, judicial, and executive departments.

The powers of the Federal government are delegated to it by the people. These powers are those which are expressed in the United States Constitution, together with powers implied therefrom or incidental thereto. All other governmental powers are reserved to the states.

The power to make laws rests with the legislative branch of our government, the judicial branch interprets and applies the laws, and the executive branch administers and executes the laws. Sometimes there may be some real or apparent overlapping of authority, but nevertheless the plan is one of the basic principles of our governmental system.

LAWS MAY BE PROHIBITIVE, PERMISSIVE, OR MANDATORY

Some people think of law as consisting of a set of rules that forbid and restrain. Such laws are known as *prohibitory laws,* and perhaps they constitute a majority of the laws by which we are governed. However, some laws are of a different nature. Such laws may be either *mandatory* or *permissive.*

Mandatory laws are just the opposite of prohibitory laws. Rather than forbidding us to do something they command us to perform certain specified acts. Examples of such laws are rules regarding taxation and rules requiring the submission of reports to the government.

Some laws aim to bestow privileges upon people who apply and meet specific requirements. Such laws are called *permissive legislation.* Examples are marriage licenses, hunting licenses, drivers' licenses and permits to enter into certain occupations such as law, medicine, and public accountancy.

As government regulation of business increases, it is probable that permissive and mandatory legislation will increase in importance. Some of these laws are prohibitive in nature, but a great many of them order things to be done or require legal permission for doing certain things. Such laws were greatly expanded during the Second World War when rationing and price controls were in effect.

LAW CLASSIFIED AS PUBLIC OR PRIVATE

Law may be classified in a variety of ways. For our present purpose we shall merely distinguish between public and private law. Private law governs relationships among individuals as such. Public law pertains to the public as a whole, and such law governs groups and individuals in their relationship with the state.

There are three general classes of public law. These are

1. Constitutional law
2. Administrative law
3. Criminal law

Constitutional law is the basis for all other forms of law. It defines the extent of the powers of the state and Federal governments in carrying out their legislative, executive, and judicial functions. Administrative law has to do with officials, boards, and commissions created to carry out legislative functions. Criminal law deals with rules forbidding conduct considered detrimental to the state.

ADMINISTRATIVE LAW INCREASINGLY IMPORTANT

A knowledge of administrative law is becoming of increasing importance to businessmen. The enumeration of all the boards and commissions that fall within the field of administrative law would make a long list. Outstanding examples are the Federal Trade Commission, the Interstate Commerce Commission, and the National Labor Relations Board. A businessman may find himself in serious difficulties if, through ignorance or otherwise, he fails to comply with the requirements set forth by these boards and commissions.

DIFFERENCE BETWEEN PRIVATE WRONGS AND CRIME

As already indicated a crime is considered a wrong against the state. A private wrong is merely a wrong against an individual. In the case of a crime the state will take the matter into its own hands. If a private wrong occurs, the state will do nothing about it until the aggrieved party presents the case to the courts. The state stands ready to assist an individual to get redress for a private wrong, but it will do nothing about it on its own initiative.

There is another important distinction between a private wrong and a crime. A private wrong may at times be committed unintentionally. A crime always presupposes intention. For this reason a very young child or an insane person cannot be held liable for crimes. Such people may however be liable in damages for a tort. The definition of a tort will be given in the next section (on private rights).

From a business standpoint private wrongs play a more prominent part than criminal wrongs. Nevertheless it should not be assumed that crimes are never committed in connection with business. Some crimes that are rather common in connection with business are tax evasion, unreasonable restraint of trade, embezzlement, and violation of certain government regulations. A businessman may at times do through ignorance something that will expose him to prosecution for certain of these crimes. It is therefore important that he should know the law on the points pertaining to his business. It is one of the basic legal principles that ignorance of the law excuses no one.

PRIVATE RIGHTS MAY BE CONTRACTUAL OR NONCONTRACTUAL

A person has certain private rights, and the violation of any of these rights constitutes a private wrong. Such violations give the wronged person the right to claim the proper legal remedy to be explained in the next section (on damages).

If you make a contract with someone you establish a specific right which did not previously exist. Your right and the right of the other contracting party arise solely from the agreement. A contract may therefore be briefly defined as *any agreement enforceable at law.* Such rights exist only with respect to the person with whom you have made the contract. You have no contractual rights with respect to people in general. Failure to fulfill one's contractual obligations is called *breach of contract.*

You hold certain private rights with respect to people in general. These are chiefly rights having to do with the safety of one's life, health, reputation, property, and livelihood. These may be called *noncontractual rights,* since no contract is required to bring them into effect. Violation of noncontractual rights is known as a *tort.* Common examples of torts are libel, slander, trespass, assault, fraud, and negligence.

DAMAGES THE USUAL REMEDY FOR PRIVATE WRONGS

The usual remedy for the violation of a private right is to compel the wrongdoer to pay *damages.* Damages are indemnification for the loss suffered by the victim rather than a penalty upon the wrongdoer. At least theoretically, the amount of damages should just equal the amount lost by reason of the wrongful act. In actual practice this ideal result is not always attained.

In connection with torts, damages constitute the only remedy. In the case of breach of contract, damages are the usual remedy, but the courts will sometimes compel the party actually to live up to his contract. This is called *specific performance* and is supposed to apply only when money damages would be an inadequate remedy. Specific performance may usually be applied to enforce a contract for the sale of a rare article that cannot be supplied elsewhere, especially if the article has a sentimental value. In most states a person who has a contract for real property may compel the delivery of the deed to the property.

KEEP OUT OF LEGAL DIFFICULTIES

In connection with the law it is frequently true that an ounce of prevention is worth a pound of cure. When a legal difficulty arises it is frequently too late to do much about it. At best the escape from such difficulties is expensive and annoying. In most instances it is advisable to avoid legal entanglements by observing all the rules and regulations. In your private dealings make sure that there is little cause for anyone to bring a claim against you. You may win the suit, but even at that it is usually a costly and unpleasant experience. In most instances it pays to seek competent legal advice in order to prevent costly legal involvements.

RIGHTS SHOULD BE ENFORCED

In the preceding section we advised keeping yourself out of legal difficulties. There is another side to the story. You may have a legal claim against someone else. In such a situation you should use a reasonable amount of discretion. If the claim is small and no particular question of principle is involved, it is sometimes better to drop it than go to the expense and inconvenience of a lawsuit. On the other hand there certainly are some situations in which bringing suit is a wise procedure. We have frequently heard about fortunes being lost because of lawsuits. Other, and perhaps greater, fortunes have been lost because of failure to instigate legal proceedings perfectly justified.

Regardless of the situation it is not advisable to rush into a lawsuit. Exhaust all other possibilities first. Let us suppose that you have a claim against a person for $1,000 either because of a tort or a breach of contract. Your general procedure might be about as follows:

1. Talk it over and try to make a reasonable settlement.
2. If settlement is refused, see a lawyer.
3. If the lawyer advises you to go ahead with the case, leave the matter largely in his hands.
4. The lawyer will then attempt to get a settlement.
5. If this fails, bring suit.

HOW MUCH LAW SHOULD A BUSINESSMAN KNOW?

We can give only a general answer to this question. The need for legal knowledge depends largely upon the nature of the business and the circumstances surrounding it. The need for such knowledge may also be minimized by seeking expert legal knowledge in connection with most of the difficult and technical points. It is probably seldom advisable for a businessman to attempt "to be his own lawyer." The chief purpose of legal knowledge for a layman is to help him keep out of legal difficulties and to assist him in determining when legal advice should be sought.

What, then, should the average businessman know about the law? First of all he should be familiar with the basic principle underlying the validity of a contract. He should also know something about the laws pertaining to certain special contracts. The most important of these topics are sales, bailments, negotiable instruments, agency, and insurance. To these may be added real estate, partnerships, and corporations. Finally, he should keep informed about the various current legislative enactments that may affect his business. This requires alertness as well as careful study.

We may conclude that every businessman should know some law. The only alternative would be to employ a good lawyer to watch over *all* his legal matters. This, however, is a luxury that a relatively small business cannot afford.

SUMMARY

Law arose chiefly from social necessity and is essential to civilized existence. Most of the laws prohibit us from doing certain things and are therefore designated as *prohibitory* laws. On the other hand, some laws prescribe certain things that we must do and these are called *mandatory* laws. Finally, there are some laws offering to bestow certain privileges upon eligible persons who apply for such privileges. Such laws are called *permissive* laws.

The chief classification of law is into public law and private law. Public law has to do with the relationships of groups and individuals with the state. Private law governs the relationships among individuals as such. Violations of public law are commonly known as *crimes*. The violations of a private right may take the form of either a breach of contract or a tort.

Laws are originated, interpreted, and enforced through our governmental institutions. Our government is first of all divided into the Federal government and the various state governments. Each of these again is divided into the legislative, judicial, and executive departments.

After all efforts have failed, the courts constitute the only place where we may seek redress for a legal wrong. However, before resorting to the courts for the enforcement of a claim, it is usually well to try to arrive at a settlement by negotiations and possibly by compromise. We should carefully consider when it pays to engage in legal proceedings or when it may be better not to appeal to the courts.

QUESTIONS FOR REVIEW

1. How and why did law arise?
2. Does the law always result in justice? Why?
3. What is meant by prohibitive law? Permissive law? Mandatory law? Give illustrations of each.
4. What is the difference between "public" and "private" law?
5. Explain what is meant by each of the three general classes of public law.
6. Why is administrative law becoming increasingly important?
7. Carefully distinguish between a private wrong and a crime.
8. Distinguish between contractual and noncontractual private rights.
9. Distinguish between breach of contract and tort. What remedies are available for each of these private wrongs?
10. Explain each of the three functional divisions of government.
11. Why should one try to keep out of legal difficulties? How may he do so?
12. How much law should a businessman know? Explain your answer.

TERMS AND PHRASES TO DEFINE OR EXPLAIN

1. Law
2. Prohibitive law
3. Permissive law
4. Mandatory law
5. Public law
6. Private law
7. Constitutional law
8. Administrative law
9. Criminal law
10. Private wrong
11. Crime
12. Breach of contract
13. Tort
14. Damages
15. Specific performance

QUESTIONS FOR DISCUSSION

1. Do you think that the "wise old men" of the tribes thousands of years ago probably settled disputes justly? Would a similar system give justice today? Why?
2. What is the "competent authority" by which laws are enforced today?
3. Which type of laws do you think is likely to increase in number during a war period, prohibitive, permissive, or mandatory?
4. What effect do you think war is likely to have on administrative law?
5. Why is it that the state will not seek redress for a private wrong to an individual on its own initiative?
6. Do you think that a very young child or an insane person should be held liable for a crime?
7. Why is it that a businessman may be prosecuted for a crime he has committed unintentionally?
8. How may a businessman best go about keeping out of legal difficulties?

CASE PROBLEMS

1. While driving his car in his own driveway, Carl Duncan saw a parked bicycle belonging to a man with whom he recently had an argument. Duncan deliberately and wantonly drove into the bicycle and ruined it. (*a*) Did this action essentially constitute a private wrong or a crime? (*b*) Could the owner of the bicycle sue Mr. Duncan for breach of contract? (*c*) Would you say the action of Mr. Duncan constituted a tort? (*d*) Could Mr. Duncan be sued for specific performance?
2. In the previous case would your answer to any of the questions

have been different if Mr. Duncan had accidentally and unintentionally driven into the parked bicycle?

3. Mr. Jones contracted to sell to Mr. Killian a particular tract of land containing a large limestone deposit and located near a cement plant owned by Mr. Killian. Mr. Jones now refuses to carry out the contract, saying he has decided not to sell the land. (*a*) Does his refusal to sell constitute a private wrong or a tort? (*b*) Will the state take the initiative in settling his case? (*c*) Might Mr. Jones be sued for breach of contract? (*d*) Might Mr. Jones be forced to pay damages? (*e*) Might Mr. Jones be forced to *specifically perform* his contract?
4. The sheriff of Black Hawk County arrests Mr. Bronson for violating a state statute requiring him to provide certain health guards for his women employees. (*a*) Does the sheriff represent the judicial, the legislative, or the executive function of government? (*b*) Would you say Mr. Bronson violated an administrative law? (*c*) Who do you suppose took the initiative in having the sheriff arrest Mr. Bronson?
5. Mr. Rhoner owns and operates a main store in eastern Iowa and a branch store that he recently opened in western Illinois. He is a young man who has been in business only a couple of years and during this time finds that he has twice been required to pay fines for violation of laws that he did not know existed. What would you suggest that he do in order to avoid such fines in the future?

SUGGESTED PROJECTS

1. Examine a current copy of some large daily newspaper and list those news items relating to legal difficulties, merely indicating the facts by a brief phrase or sentence. Then see which ones seem to be crimes, which ones torts, and which ones breaches of contracts.
2. Bring to class a list of ten illustrations of ways in which a businessman may quite easily but unintentionally violate the law if he is not well informed. If possible, include some for which the penalty may be a fine of $5,000 or more, or imprisonment.
3. Consult recent issues of *Forbes Magazine,* or some other reference suggested by your instructor, select an article dealing with recent legislation, and report on it. Show how this legislation fits into the general classifications listed in this chapter.

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4. Communication and transportation

PREVIEW: Transportation and communication are very important cogs in the general machinery of business. Without them our economy could not function as we know it today. There could be no specialization or big-scale production, no national advertising, and no dissemination of market information.

Has the development of transportation and communication been rapid or slow? What, if any, regulations are imposed? Are facilities adapted to our varied needs?

COMMUNICATION AND TRANSPORTATION CLOSELY RELATED

There is considerable resemblance between the purposes served by communication and those served by transportation. Both involve the question of transfer. In the former we have the transfer of ideas: the latter involves the transfer of goods or persons.

Insofar as their application to business is concerned, communication and transportation may be looked upon as tools and devices to be used for the benefit of business and society as a whole. To a greater or less extent these agencies are available to all, and it is quite certain that modern business would be paralyzed without them.

IMPROVEMENT ORIGINALLY SLOW

There was a time when the only methods of communication consisted of spoken words and some crude efforts at signaling. Messages sent a distance were entrusted to the memory of persons who either traveled on foot or used such crude conveyances as were then available. Gradually some form of writing was invented, and this considerably increased both the reliability and the permanence of the ideas that were to be transmitted.

From the time of the invention of writing little of importance happened in the field of communication until the fifteenth century, when printing came into common use. Then there was a lull for four hundred years, after which a good postal system and the use of the telephone and telegraph were introduced. Radio is a child of the present century. We thus see that communication as we have it today is largely a development arising during the last hundred years.

Transportation presents substantially the same story. No doubt walking was the first form of personal travel, and freight transportation was limited to whatever could be loaded upon human backs. Perhaps the next step was the discovery that a person could glide down a stream on floating objects, and this led to the introduction of boats. When animals were domesticated, some of these became beasts of burden and greatly expanded the potentialities of transportation. When one day some ingenious man developed the idea of the wheel, the contribution of the prehistoric period was complete.

For several thousand years the only important contribution to transportation consisted of improvements in the methods that were already known. Transportation by horse, donkey, camel, elephant, and carriage was improved. Sea transportation became more efficient because of bigger and better ships, the introduction of sails, and more knowledge of seamanship and navigation. Land transportation was further facilitated by means of better roads, and sea travel, in many cases, became safer and more expeditious by following certain well-explored routes.

But at that point improvement stopped for a long time. In conformity with what we have said about communications, the beginning of mass transportation goes back only slightly more than a hundred years. First came the steamboat, soon followed by steam railway locomotives. Electric trains were introduced during the last quarter of the nineteenth century. A large proportion of the people now living remember the first automobiles. Air transportation has been of importance only for the last twenty years.

TRANSPORTATION THE LIFEBLOOD OF INDUSTRY

The statement that transportation is the lifeblood of industry may be merely a hackneyed repetition of a truism. However, there are some who do not fully realize the full significance of the truth expressed in such a metaphor. Animal life could not exist without a circulatory system. In the same manner industry and commerce would completely stagnate in a few days if our transportation system were completely demoralized. People would soon revert to the barbaric stage of economic isolation.

The scope of our transportation system may be gleaned from the fact that, including automobiles, we spend more than 20 per cent of our national income on the various forms of transportation. This huge expenditure arises from our vast territorial expanse, the high degree of regional specialization, and our high standard of living.

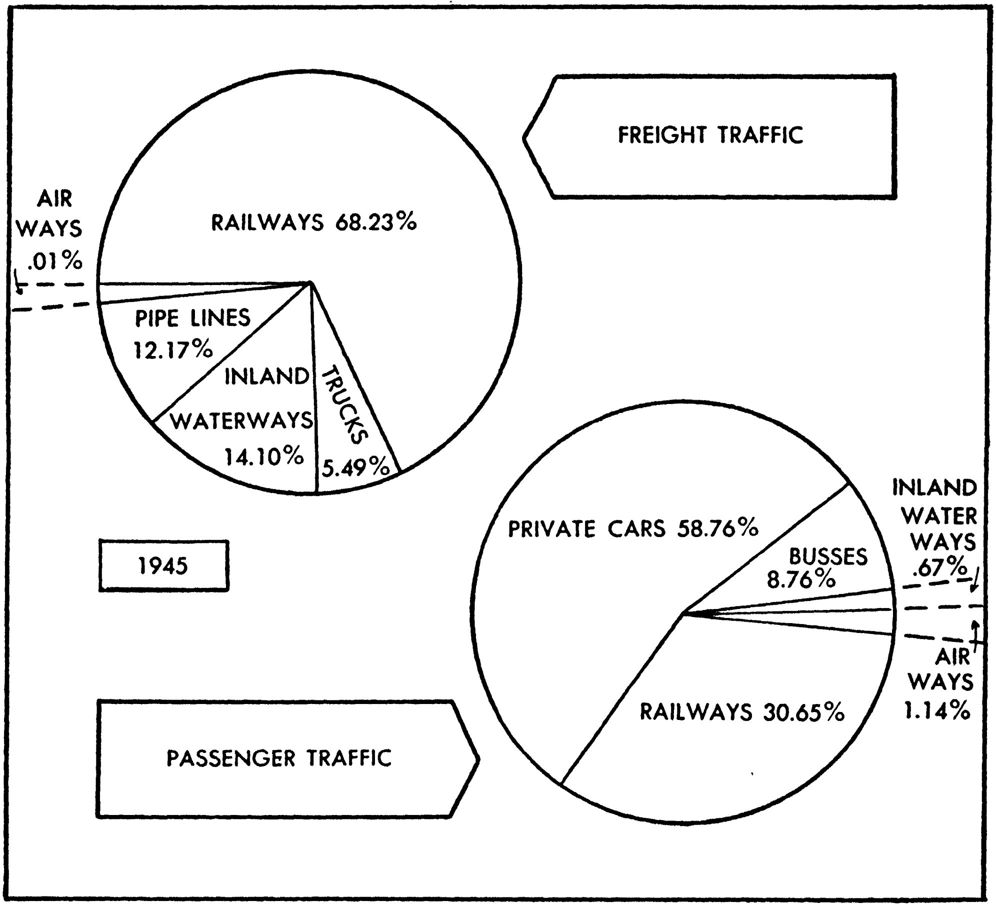
There is a close connection between mass production and the development of transportation. Mass production gives rise to a demand for wider markets, and better transportation comes in to meet that demand. The improved transportation gives further encouragement to mass production, and this process goes on in a continuous cycle of progress.

A WISE CHOICE OF TRANSPORTATION

A person who has something to ship usually has a wide range of choice as to transportation facilities. The various agencies available for the transportation of goods are chiefly as follows:

1. Railway freight transportation
2. Express (mostly carried over railroads)
3. Parcel post
4. Water transportation
5. Truck lines
6. Private automobiles and trucks
7. Airlines
8. Pipe lines

Although railways have had increasing difficulties in holding their own, they are still the principal means of long-distance hauling of bulky goods. For many years truck lines have increased in importance. In the future the most sensational advances will perhaps be made in connection with air transportation. The efficiency gained in airplane construction during the Second World War presaged future developments that may prove almost revolutionary in future transportation.



VOLUME OF TRAFFIC. (Data furnished by the Interstate Commerce Commission.)

TRANSPORTATION FOR EVERY NEED

A businessman can frequently profit greatly by choosing the proper transportation to fit each particular situation. The outstanding factor is that of speed as compared with cost. There must also be considered the fact that certain products just don't lend themselves to certain methods of shipment. In other cases the form of transportation desired may not be locally available. Some of the advantages of various forms of transportation will be briefly discussed.

Railway freight transportation. In most places this is practically the only method available for certain types of products. Such products include coal, grain, timber products, and most of the bulky materials. For long-distance transportation the railways can hold their own for almost any products shipped in carload lots. Cost of freight transportation by rail in the United States averages less than 1 cent per ton-mile.

Express and parcel post. These methods of transportation are largely interchangeable, since they serve essentially the same purposes. They are more speedy than ordinary freight services, ensure more careful handling, and are actually more economical for small packages, since freight service usually has a minimum charge based on 100 pounds. Express and parcel post are competitive agencies, and the charges, although not identical, fluctuate around the same level. Most express and parcel-post shipments are handled by the railroads.

In 1943 over 1½ million shipments were made in the United States by air express. The average weight per shipment was 19.9 pounds. In 1938 the average weight per shipment was but 6.6 pounds.

Water transportation. This form of transportation suffers from territorial limitations. It is carried on in connection with foreign trade, coastwise traffic, and inland traffic such as on the Great Lakes and navigable rivers and canals. Where available it is generally the cheapest kind of transportation, but it is relatively slow, and time schedules are frequently nonexistent or irregular. However, huge quantities of coal, mineral ores, building materials, grain, and other heavy products are shipped in this manner.

THE LEGAL STATUS OF COMMUNICATION AND TRANSPORTATION

Our various communication and transportation agencies may be classified as being either *public* or *private.* Private service in these fields consists of either communication and transportation that individuals or business concerns provide for themselves or that provided for a select group on a contractual basis. Public communication and transportation include agencies that hold themselves out to serve the public as a whole. Such concerns are known as *quasi-public* or *semipublic.* They are usually privately owned but are assumed to be under certain special obligations to the public as a whole and are strictly regulated by the government.

There is no special law applicable to private communication and transportation beyond such rules as pertain to contractual dealings in general. Thus, if A, B, and C employed D to deliver groceries for them, D would be a private carrier, since he did not hold himself out as carrying goods for the public in general. Similarly an internal communications system within a certain business or within a small group of related businesses would not be subject to public regulations.

SERVING THE PUBLIC IS A DIFFERENT PROPOSITION

From this point on it is more convenient to treat transportation and communication separately, since each is subject to somewhat different rules. As already indicated, transportation companies *serving the public* are subject to certain special rules. Such transporters are known as *common carriers.* Transportation and communication are both closely associated with the public welfare and must therefore observe certain rules of conduct.

Common carriers are subject to regulations that govern this conduct and establish their responsibilities.

1. They are compelled to render universal service and cannot select their customers.
2. They must treat everybody alike.
3. They have exceptional liability with respect to the safety of goods transported.
4. The rates and the nature of the service are regulated by law.

Most businesses may choose their customers and may refuse to deal with certain parties for any reason or no reason. To the limit of their capacity and to the extent of the nature of their business, common carriers must, in general, serve anyone who is willing to pay the price. Furthermore such carriers can have no favorites.

They must follow certain rates and schedules and treat everyone alike.

In a limited sense common carriers are insurers of the goods entrusted to them for transportation. This means that they are usually liable for loss or damage even if no negligence is proved against them. However, common carriers are relieved of liability in the following instances:

1. If the loss is due to an act of God. This means some unusual natural disturbance over which man has no control, such as earthquakes and tornadoes.
2. If it is caused by public enemy. This applies only in case of war.
3. If delivery is prevented by public authority.
4. If loss is caused by the inherent nature of the goods.
5. If the shipper himself was primarily to blame.

Where statutes permit, the common carrier may partly relieve himself of his extraordinary liability. However, he can never contract away his responsibility to use reasonable care.

The rates to be charged are strictly regulated by law and must be made a matter of public knowledge. Common carriers are also regulated on many other points and may not suspend operation. Carriers operating in more than one state are under the supervision of the Interstate Commerce Commission. This is the oldest of the independent regulatory agencies of the United States, having been created by Congress in 1887. Transportation carried on entirely within a given state is regulated by a commission within that state. The title varies, but *state railway commission* is the most common designation.

REGULATION OF COMMUNICATIONS

Telegraph, telephone, and other similar forms of communications are regulated somewhat in the same manner as common carriers. Companies operating such communications must serve the public in general and must treat everybody alike. The rates are regulated, and everyone pays the same price for similar services. The public communication systems do not generally act as insurers of the messages, but they must exercise great care and can easily be held responsible if even slight negligence can be shown in the transmission of messages.

The Postal Department stands in a class by itself, since it is owned and operated by the government. The department may prescribe rules as to the nature of the mail to be handled and the manner of transmission. Subject to these rules, the Postal Department must serve everybody and cannot discriminate among individuals. The department usually aims to charge rates that will make it self-supporting. Deficiencies are provided for by congressional appropriations for that purpose.

The Federal Communications Act of 1934, as amended (U.S. Code, Title 49, Secs. 151–609) gives the Federal Communications Commission broad regulatory powers over radio stations in interstate or foreign commerce. Broadcasting stations must secure licenses from the commission.

SUMMARY

Progress in transportation and communication was very slow until about a hundred years ago. In fact if we go back as much as seventy-five years, we find that most forms of present-day transportation and communication systems were either nonexistent or meagerly developed.

Business cannot operate successfully without efficient systems of transportation and communications. A wise choice of services to fit particular needs will make such services all the more useful. In that connection it should be remembered that the cheapest system is not necessarily the most economical.

Transportation and communication systems that serve the public in general are subject to strict government regulation and must serve everybody without discrimination.

QUESTIONS FOR REVIEW

1. What similarity exists between communication and transportation in respect to purpose? Distinguish between the two.
2. Why are communication and transportation of significance in the study of business?
3. What were the typical early methods of communication? What in-

ventions of comparatively recent date were responsible for great improvements in communication?

4. What were some of the various steps in the development of transportation? In what ways did improvement for many centuries consist mostly of improvement in methods already known?
5. What has happened to transportation during the last century?
6. What are the important agencies of communication? How can the businessman know which one he should use?
7. Why may transportation be referred to as "the lifeblood of industry"?
8. What are the main transportation agencies available to the businessman?
9. For what type of products is railway freight transportation most valuable?
10. What are the advantages of express and parcel post?
11. Is water transportation usually expensive? Illustrate the type of materials for which it is particularly useful.
12. What laws apply to private communication and transportation services?
13. What is meant by a "common carrier"? Explain the four important legal rules that govern their services.
14. Under what circumstances is a common carrier relieved of his liability as an "insurer" (in a limited sense) of the goods carried?
15. What general rules regulate communication services? Which particular service is in a class by itself? Why is this?

TERMS AND PHRASES TO DEFINE OR EXPLAIN

1. Communication
2. Transportation
3. Freight
4. Express
5. Parcel Post
6. Common carrier
7. Private transportation
8. Act of God
9. Public enemy
10. Interstate Commerce Commission
11. Federal Communications Commission

QUESTIONS FOR DISCUSSION

1. Do you suppose much "business" was carried on before writing was invented or known? Why?
2. Even after the invention of printing, in what ways was business hampered by lack of communication as compared to what is available today?

3. The invention of the wheel was recognized as a great step forward. Why was this?
4. To what extent was mass production responsible for recent improvements in communication and transportation, and vice versa?
5. How would you probably be gaining your livelihood if we had no transportation services available?
6. How is the type of transportation service to be used directly related to the type of business one is in?
7. Why do we have certain rules regulating common carriers?
8. Why do you suppose the rules regulating communication services are somewhat different?

CASE PROBLEMS

1. Timothy Olson runs a general store in the little village of Ackley, Iowa. During the winter months he is checking his stock of goods and decides he must have several kegs of staples for repair work on farm fences in the spring. Ackley is served by a line of the Illinois Central Railroad and also by a main paved highway to Chicago. He wishes to purchase the staples from a wholesaler in Chicago. (*a*) Which communication service will he probably use in ordering the staples? (*b*) Which transportation service do you think he would use in getting the staples sent to Ackley?
2. Owing to contracts to manufacture war supplies that are urgently needed, a large war plant has been constructed and equipped in Tennessee. Labor is not plentiful. It is necessary for the management of this plant to inform potential workers in all parts of the United States of the need for help in this plant, and of wages, living conditions, etc. What method or methods of communication might well be used for such a purpose?
3. A ship in the U.S. Naval Service is scheduled to leave port at 1930 hours (7:30 P.M.) on 15 November 1944. On the morning of that day an officer newly assigned to the ship discovers that a crate containing vitally needed radio equipment awaiting his help for installation has accidentally been damaged. The necessary repair part can be obtained only in Michigan. What communication and transportation services might be used to get the part and allow the ship to leave on schedule?
4. The distributor of a nationally advertised brand of ground coffee knows that he must annually secure enormous quantities of coffee beans from Brazil and certain Central American countries. In order to set a standard price for it, he must constantly contract for his

supply far in advance of needs; in order to guard against crop shortages, etc., he must keep a reasonable quantity in storage. What communications and transportation services would he likely be using in securing his supply of coffee beans?

5. A certain interurban railway company serves a number of communities with short "feeder" lines running from the main line out to these small communities. Passengers and goods moving over one of these lines have constantly decreased in quantity owing to competition of paved highways until the line is now operating at a loss. If they decide to do so, can the officials of this company discontinue the use of this feeder line?
6. Norman Johnson owns a large truck and earns his living entirely by doing long-distance hauling. He advertises in the daily paper that he is equipped and ready to do such hauling; he has never refused to haul for anyone willing to hire him. He sets his price for any given task by estimating the weight of the load to be hauled and then charging a set price per pound per mile. He will haul to any part of the United States. Would you say Mr. Johnson is a common carrier?

SUGGESTED PROJECTS

1. Investigate and report on the methods used in keeping written records before paper was invented and placed in use.
2. Determine what the reasons were for the first extension of railroads into the Middle West and West.
3. Secure the names of leading air lines in the United States and report on the equipment and services available by air. What plans for future expansion seem to be in process?
4. Prepare a summary of practical information about rates and regulations of the Postal Department that every business office may need for reference. If possible have it duplicated for all members of the class.
5. Determine the main classifications into which goods are divided for railway freight rates, and the relative cost of shipping goods in each classification.
6. Compare the cost of shipping small and medium-sized parcels by express and by parcel post. Does express offer special lower rates on any particular types of goods?
7. Report on the different types of messages that may be sent by telegraph, and the various rates charged.
8. Have different members of the class interview various retailers and

find out which transportation services are most frequently used by each. Include a grocer, butcher, druggist, hardware dealer, clothier, shoe dealer, variety store manager or owner, drygoods store operator, etc.

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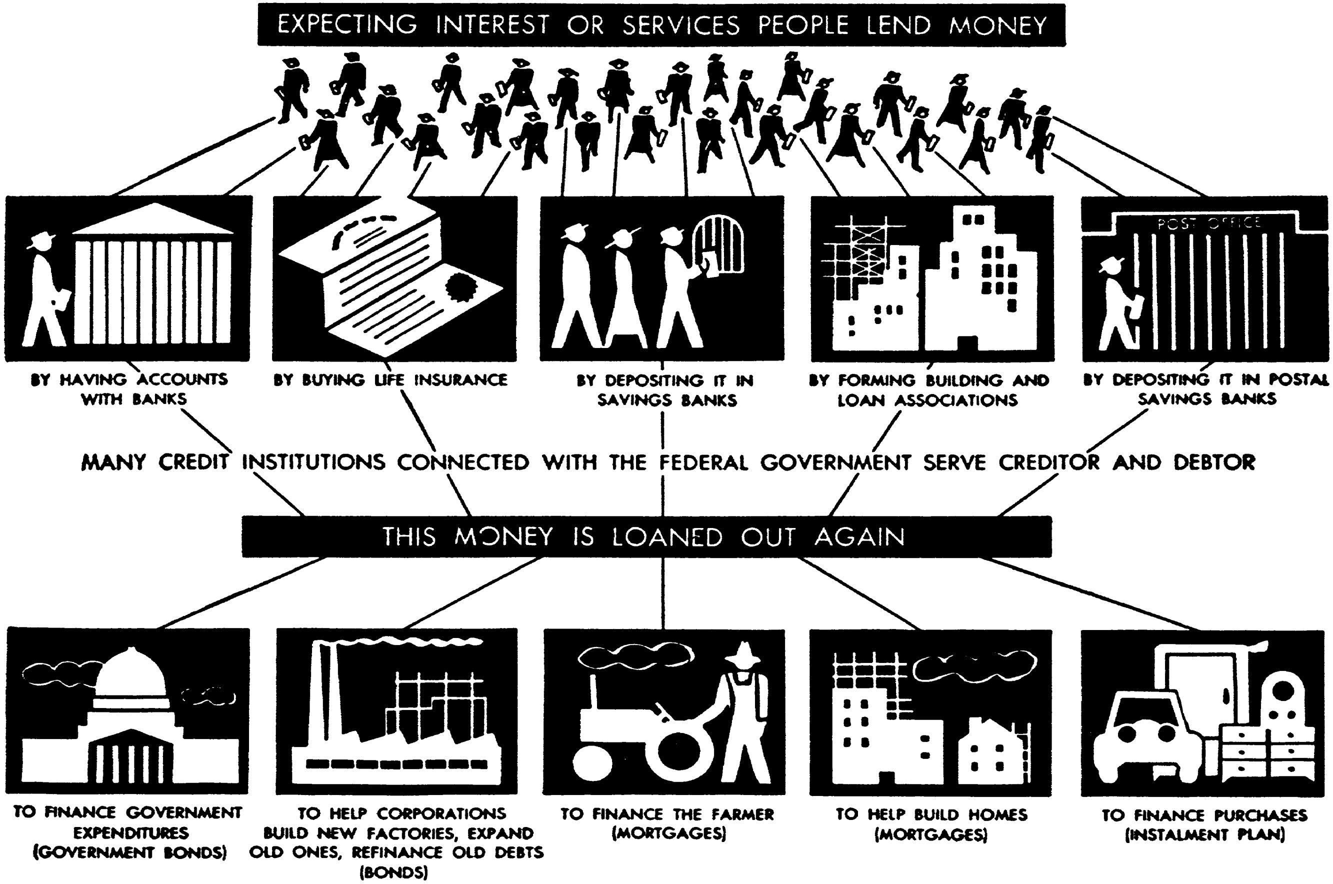
5. Money, banks, and credit

PREVIEW: Modern business must have a sound medium to facilitate the free exchange of goods and services. Money and, to some extent, credit have been established as the significant media of exchange. Money as we know it today has not always served the business system. The amount of money in circulation is an important factor in the stability of our economy. The commercial bank is the important central point of the essential financial activities of our business system. How did money develop as a medium of exchange? What determines the value of money? How may the purchasing media be increased? How may they be decreased?

MONEY AND CREDIT CAN DO MUCH

People are not necessarily limited by their present supply of money. They can buy a certain amount on credit. Of course the debt must be paid eventually, but a responsible businessman or other reliable person may obtain a line of credit extending over a period of time. The purchasing media of a community as a whole may sometimes be considerably increased from the reservoirs of excess available credit normally held by commercial banks. This interesting process will be discussed later. For the present let us merely keep in mind that an individual's total potential purchasing power consists of his money plus the amount of his probable credit.


EXPECTING INTEREST OR SERVICES PEOPLE LEND MONEY
POST OFFICE
BY HAVING ACCOUNTS WITH BANKS
BY BUYING LIFE INSURANCE
BY DEPOSITING IT IN SAVINGS BANKS
BY FORMING BUILDING AND LOAN ASSOCIATIONS
BY DEPOSITING IT IN POSTAL SAVINGS BANKS
MANY CREDIT INSTITUTIONS CONNECTED WITH THE FEDERAL GOVERNMENT SERVE CREDITOR AND DEBTOR
THIS MONEY IS LOANED OUT AGAIN
TO FINANCE GOVERNMENT EXPENDITURES (GOVERNMENT BONDS)
TO HELP CORPORATIONS BUILD NEW FACTORIES, EXPAND OLD ONES, REFINANCE OLD DEBTS (BONDS)
TO FINANCE THE FARMER (MORTGAGES)
TO HELP BUILD HOMES (MORTGAGES)
TO FINANCE PURCHASES (INSTALMENT PLAN)

THE FUNCTION OF DEBTS. (Reproduced from "Debts—Good or Bad?" by Maxwell S. Stewart, courtesy of the Public Affairs Committee, Inc., New York.)

WHAT IS MONEY?

We might briefly dispose of the definition of money by merely saying that it is a medium of exchange. This definition is not entirely satisfactory, since credit also serves to a limited extent as such a medium. A more complete and specific definition of money is as follows: Money is anything that passes freely from hand to hand and is unquestionably accepted by everybody as payment because of specific and definite governmental assurances of validity. Thus, a personal promissory note or check should not be classed as money. These papers are used as money substitutes, but they are not money, since they are not universally acceptable.

In our day it is sometimes difficult to distinguish between money and credit. Our personal promissory notes or our offer to buy on credit are not money, since this manner of settling our debts may be refused. The same is true of our checks and drafts. On the other hand, bank notes and treasury notes (paper money) are classed as money, notwithstanding the fact that essentially they are nothing but promises to pay. It is an interesting cycle. You have some paper money (promises to pay). With this you buy a government bond, which is another promise to pay. When you cash in on your bond, the government gives you some other more or less crisp promises to pay, and so on ad infinitum.

MONEY WAS NOT "INVENTED"

Money did not arise from the fact that some ingenious person decided that it was about time that man began using money. Money as we know it arose from a perfectly natural chain of developments and had its origin in the desire to facilitate the exchange of goods and services.

Originally man produced what he needed for himself. After a while he found that he had more than he needed of certain things and at the same time suffered shortages in other things that he desired. The natural thing was to exchange with others to gain mutual advantages. Soon the idea developed of producing only a certain portion of the commodities needed, relying upon trading for the supplying of his remaining needs.

BARTER WAS CUMBERSOME

At first the process of trading was carried on by means of pure *barter*. Each person would look around for someone who had what he wanted and who, at the same time, was willing to accept what the first party had to offer. The difficulties of this method can well be imagined. To show how difficult and cumbersome pure barter could be, let us assume that a man had an excess supply of sheep. He was quite anxious to trade a sheep or two for a supply of figs. After looking around for a while, he found a man who had the figs but did not want any sheep. Later he located a man who was quite willing to take the sheep, but he did not have any figs. Most of the people he approached neither had figs nor wanted any sheep.

The difficulty of pure barter was largely solved when in the various communities it was discovered that there were certain commodities for which there seemed to be a practically universal demand. For instance, herdsmen were nearly always willing to increase their possessions of sheep or cattle. When the system of accepting a certain commodity as a universal medium of exchange was introduced, the plan moved forward of its own momentum. A person who had no intrinsic interest in sheep would be quite willing to accept the animals if he knew that he could exchange them for anything that he wished to buy.

MONEY HAS PASSED THROUGH SEVERAL STAGES

It would be an interesting but time-consuming pastime to list all the various commodities that at different times have been used as money. The most important point to remember is that over the years nearly all the other forms of money were abandoned in favor of gold and silver as the basic form of money. Until the money system was disturbed by the First World War (1914–1918), the greater part of the commercial world was operating on a gold standard, with a few clinging to the use of silver. This did not necessarily mean that gold and silver enjoyed much circulation, but any kind of money in use possessed eventual redeemability in the precious metals.

In the beginning gold and silver were measured out like other commodities. For instance, we read in the Bible that Abraham measured out certain "shekels of silver" to pay for his wife's burial place. After a while the idea of coinage developed, and certain uniform pieces were assigned definite values.

Then as now the desire for money was insatiable. It was not long till the rulers discovered that they could introduce a rather painless form of taxation by debasing the money. Some of the baser metals were mixed in with the gold and silver without reducing the nominal value of the coin. In this manner a handsome profit could be made, consisting of the difference between the cost of the cheaper metals and that of gold or silver.

BUT PAPER IS STILL PAPER

Something resembling our present paper money has been used at various times during the periods of the remote past. Our present system developed from the practice of goldsmiths. About the time of Christopher Columbus the custom developed of depositing valuables with goldsmiths. These craftsmen discovered that it was possible to lend a portion of the gold and silver at interest, since they could safely assume that not everybody would call for his metal at the same time. Later they even went so far as to issue scrip or notes in excess of the total amount of metal on hand, and these papers circulated quite freely somewhat like money.

This particular function of the goldsmiths was eventually taken over by banks, and paper notes far in excess of the amount of metal on hand began to circulate under the blessing and regulation of governmental authority. Later the government itself began to issue notes of its own along with those circulated by the banks. However, during this period some regard was usually maintained for the amount of gold and silver available for possible redemption of the paper. The holder of paper money could demand gold in the amount stated on the paper, although this was seldom done. We were on what is known as the *gold standard.*

We are now experiencing the latest phase of money development. Beginning with the First World War country after country went off the gold standard. Even in our country, paper money is not at present universally and freely redeemable in gold. Although our government does have more than $20 billion of gold stored away, it is not used for the redemption of paper money.

HOW CAN MERE PAPER HAVE VALUE?

Confidence in our government is the important factor in establishing the general acceptance of paper money. The government is perfectly willing to accept the paper in payment of taxes, settlement of claims, and purchase of bonds; so why should the rest of us hesitate to accept it? We know that, if we get a $10 bill, we can buy goods and services as readily as we formerly could with a $10 gold piece. As long as whatever money we have to offer will buy things at reasonable prices, few persons worry about the intrinsic value of the medium of exchange that is being offered. Paper money without any specific commodity backing is readily acceptable in this country.

BANKS FACILITATE THE HANDLING OF MONEY

If tomorrow morning you should receive $10,000 in cash and had to keep it in the house for a long period of time, you might be both inconvenienced and worried. You would likely deposit the money in a bank, get a checkbook, and start writing checks. Insofar as handling cash is concerned, your worry would be over.

Depositing money in the bank and writing checks is a great convenience. If you have a considerable amount of money, you may deposit a portion to a savings account and receive at least a small amount of interest while you are waiting for a convenient time to use the money. The bank too is well satisfied with the arrangement, since it can safely lend a considerable portion of its deposits and receive interest.

The chief functions of commercial banks are to receive deposits, cash checks, and lend money. In addition to this a bank will render other services, such as selling various commercial papers, providing change, furnishing safe-deposit boxes, and collecting on drafts and notes. It would be impossible for our business system to function fully without these routine services rendered by banks.

DO BANKS "CREATE" MONEY?

Banks are able to expand the purchasing media of a community. There are some who imply that this is a rather nefarious business only a little more respectable than that of professional counterfeiters.

It cannot be denied that commercial banks do perform a function in regulating the purchasing media. It should, however, be remembered that this manipulation of circulating credits may work either way. Bank credit is not always and forever expanding. Under given conditions credit is just as apt to be contracted by the banks. If properly regulated and operated this expansion and contraction of credit may serve a useful purpose in providing the proper amount of purchasing media to keep pace with changes in the business volume. If the system is abused, it may indeed become nefarious. This is true, not because the banks necessarily profit exorbitantly from credit manipulations, but because extreme inflation or deflation may have disastrous effects upon the business community.

HOW DO BANKS CREATE PURCHASING MEDIA?

Many people fail to grasp how it is possible for banks to expand the purchasing media of a community. True enough, the banks lend money, but it would seem that this could not be done unless the same money were borrowed from others. In that case one gives up the money that the other gets and there is no *net* increase. Similarly it might seem that the use of checks would not increase the money supply, since we must first deposit the very money that we later expect to draw out.

The crux of the whole problem lies in the fact that in normal times a bank can have deposits outstanding that are several times larger than the amount of cash on hand in the vaults of the bank. This is true because the officials of the bank know that only a small portion of the depositors will call for actual cash at one time. When cash is withdrawn, it soon flows back into the bank, and thus the amount of cash on hand tends to be relatively stable.

This process can best be illustrated if we can assume that there is only one bank in the country. We shall suppose that some enterprising men have a total of $1,000,000 on hand and they decide to start a bank. At first their balance sheet would be approximately as follows:

Bank X: Balance Sheet

Cash	$1,000,000	Capital	$1,000,000

Now if the bank makes loans totaling $5,000,000, and if for the present this is the only transaction entered into by the bank, the balance sheet would appear as follows:

Bank X: Balance Sheet

Cash	$1,000,000	Capital	$1,000,000
Loans and discounts	5,000,000	Deposits	5,000,000

Now how was it possible for the bank to lend $5,000,000 and still have as much money as before? How did the deposits increase to $5,000,000? The reason why this is possible is that most people who borrow from the banks request credit to their accounts rather than withdrawal of cash. Of course the borrower will soon draw checks for the major portion of this loan-created deposit. But what happens to these checks? Usually they are deposited in the bank. There is but little demand for cash, and thus the total deposits tend to remain in substantially their original position. As further loans are made, loans and discounts will increase and so will the deposits. The only limit to this process from a legal point of view is that the cash must be up to at least a certain percentage of the deposits. This percentage varies with different kinds of banks and is changed by law from time to time. Roughly it may be said that it runs from 10 to 20 per cent.

The effect of the foregoing on business is obvious. Before the bank was started this community had purchasing power amounting to $1,000,000. Through *loan-created* bank deposits the purchasing power is increased to $5,000,000.

When there are several banks in the country, which there always are, the increase in bank deposits through loans operates in essentially the same manner but through a more complicated process. The essence of the method is that normally the various banks in the system will continually be making loans and thus creating deposits. Checks drawn against these loans will usually be redeposited either in the bank on which they were drawn or in some other bank in the system, thus approximately perpetuating the original deposits almost as effectively as if there were only one bank. One disrupting factor is that a bank that has checks on other banks can demand settlement in cash, and this may drain off some of the cash reserves of particular banks. As a matter of fact this does not greatly affect the situation, since the claims of certain banks are usually almost offset by claims of other banks against them. Only the slight differences between these off-setting claims are paid in cash. This process is known as *clearing* and the place where it is carried out is called a *clearinghouse.*

Let us repeat—the total effect of loan-created deposits in all banks in the system works out, in the end, very much in the same way as if there were only one large bank.

HOW ARE TOTAL DEPOSITS EVER DECREASED?

So far we have talked as if bank deposits would forever continue to increase. This of course is not the case. Then how does a *decrease* in the deposits come about?

We have found that deposits increase by reason of leaving the proceeds of loans as deposits subject to check. It follows that a *net decrease* in loans has the opposite effect—it will reduce the deposits.

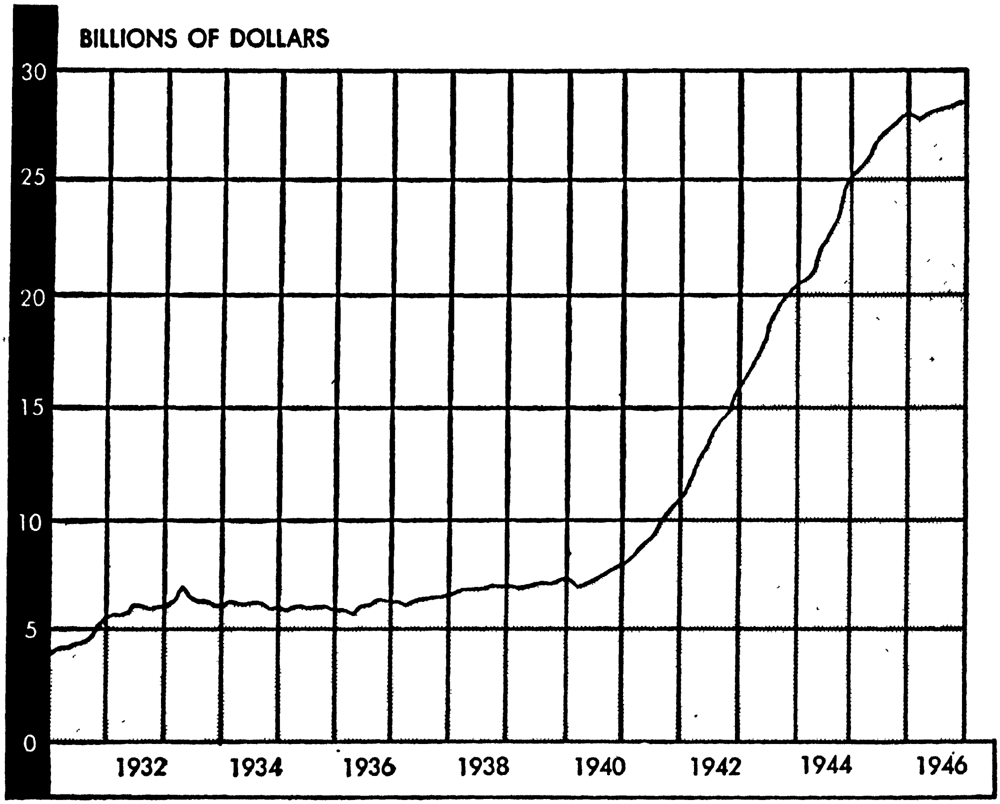
By way of illustration, a part of a bank balance sheet appears as follows:

Loans and discounts	$4,500,000	Deposits	$5,000,000

The loans were reduced by $1,000,000, and, since they were paid by checks drawn on the same bank, deposits were reduced to an equivalent extent. As a matter of fact, alternating expansions and contractions in loans and deposits are continually going on. In normal times these fluctuations are not very great.

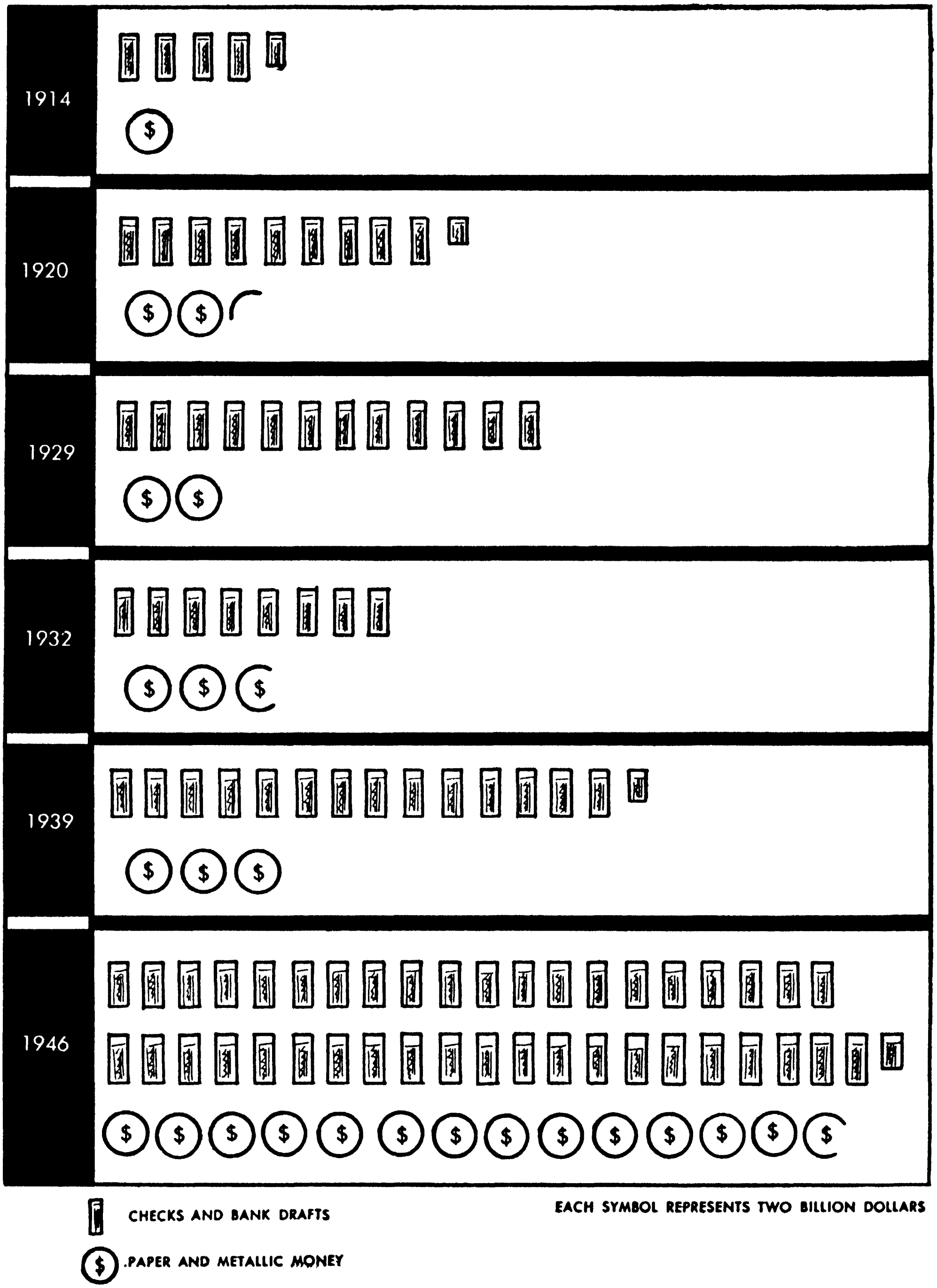
WHAT IS INFLATION?

We have several times used the term *inflation* without attempting a definition. Inflation is a situation existing when the general price level increases owing to an increased offering of money (or money equivalents) in relation to the available goods and services offered for sale. From this it will be noted that the price level is an expression of the ratio between money offerings and the availability of goods and services. Usually this comes about by reason of an increased amount of money or its equivalent without a corresponding increase in goods. Conceivably it could come about by reason of a decrease in goods without a corresponding decrease in money. The latter situation, however, seldom occurs.



TOTAL U.S. MONEY IN CIRCULATION. (Courtesy of Board of Governors of the Federal Reserve System.)

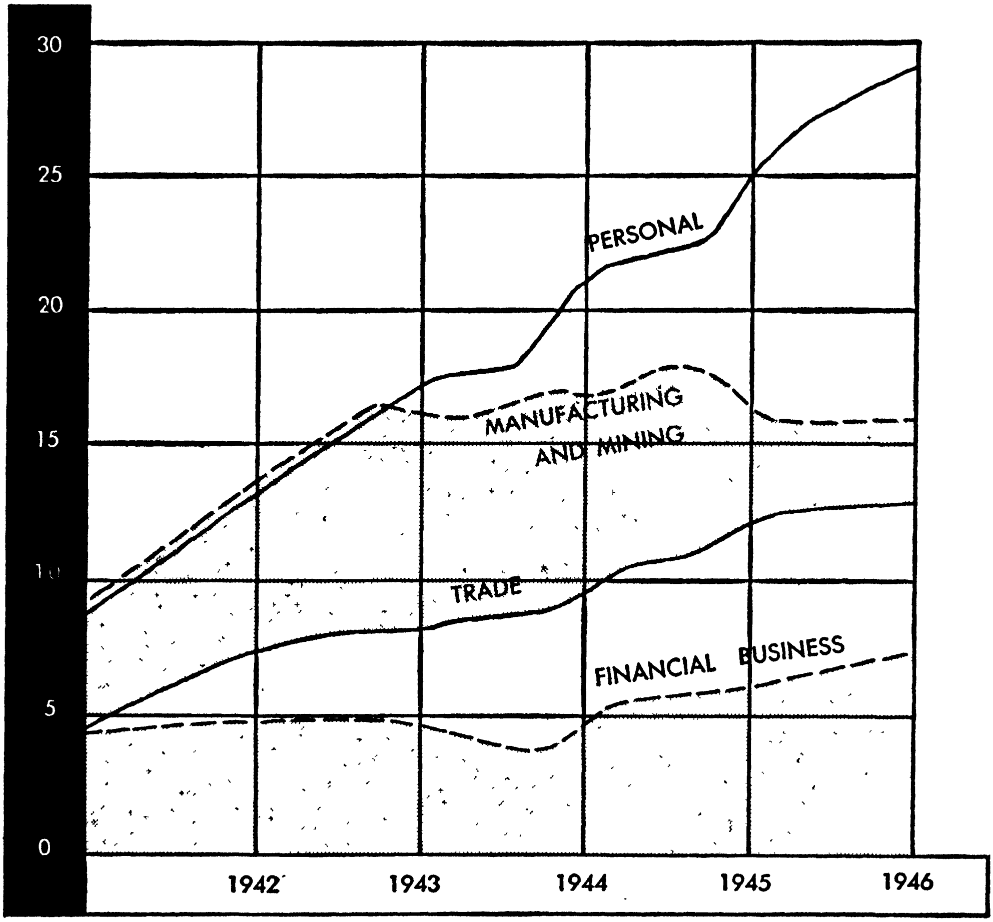
If you suddenly received an extra $100 that you did not expect, you probably would not keep the money lying around; you likely would be tempted to buy something. Suppose the same thing happened simultaneously to every person in the country. The stores would be swamped with customers. Shelves and warehouses would soon approach depletion. Factories would hum with in-



MONEY IN THE U.S.A.

creased activity. Demand would outstrip supply. Inflation would be on.

In the main the relative value of the dollar is affected by the supply of and demand for commodities and by the amount of money available.



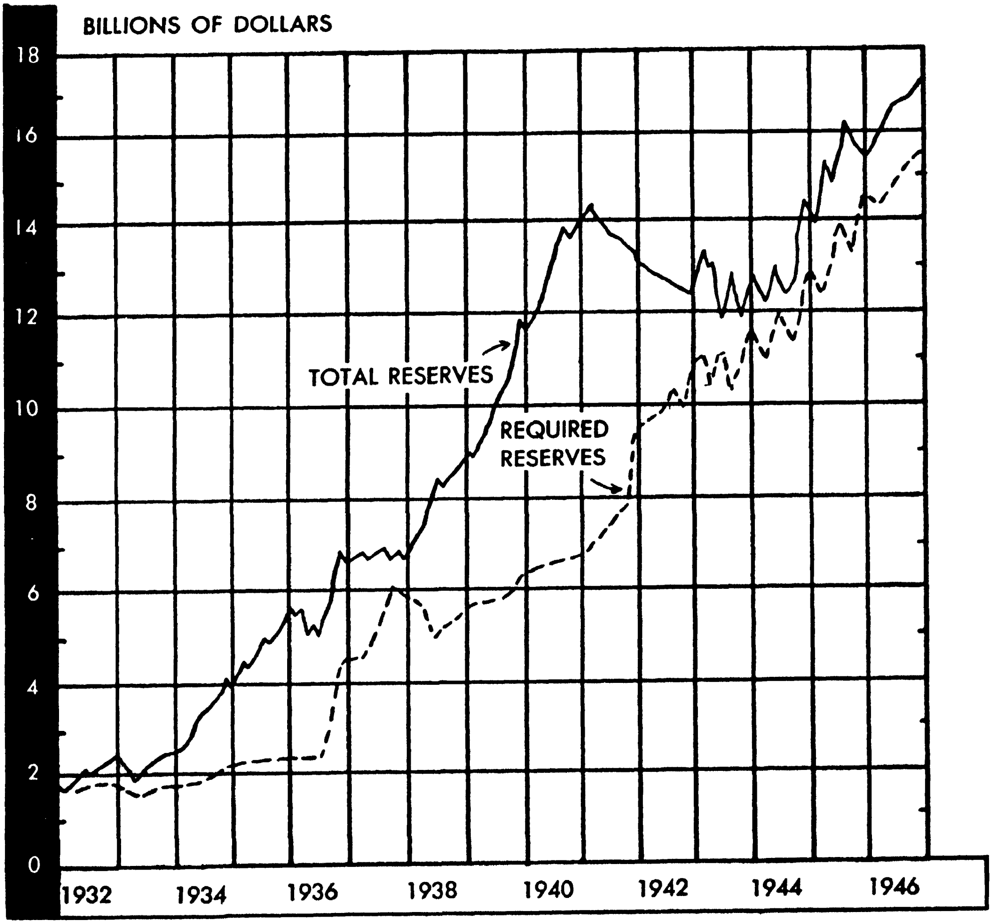
OWNERSHIP OF DEMAND DEPOSITS. (Federal Reserve Bulletin, November, 1946.)

THE OPPOSITE IS DEFLATION

On the other hand let us suppose that for various reasons money and credit are reduced. Since the same amount of goods is still on the market, prices would tend to fall. In contrast with the illustration in the previous section, we may now assume that each person in the country lost $100. The decreases in purchases and the ultimate effect upon prices can well be imagined.

EXPANSION AND CONTRACTION OF BANK CREDIT

Many more or less uncontrollable forces complicate the problem of inflation and deflation. The process by which the manipulation of money and credit may affect inflation and deflation will be explained.



REQUIRED AND TOTAL RESERVES OF MEMBER BANKS. (Courtesy of Board of Governors of the Federal Reserve System.)

Inflation or deflation can be brought about in two ways: through manipulation of the supply and circulation of paper money and through alternating expansion and contraction of bank credit. The latter method is the more common in this country.

If a sovereign government is so inclined, there is of course no limit to the possibilities of printing paper money. If such money is redeemable in gold, silver, or other relatively scarce commodity, the supply of such commodity acts as a check. Where such redeemability does not exist, the supply of paper money becomes largely a matter determined by the degree of prudence exercised by the government.

The expansion of bank credit is limited by what is known as *reserve requirements.* This means that the banks are required to maintain a certain ratio between cash on hand and deposits. For instance, if such a ratio is 1 to 5, it means that a bank with $5,000,000 of deposits must always have at least $1,000,000 of available money with which to meet the current demand for cash by the depositors. This provides a limit beyond which bank-credit expansion may not go.

Unfortunately laws may be passed permitting considerable bank inflation. Reserve requirements may be lowered, and reserves may be almost indefinitely created, since laws can be passed permitting anything that passes as "lawful money" to be used as reserve. It thus follows that currency expansion is frequently accompanied by bank-credit expansion.

In brief, inflation may be limited only by the prudence and foresight of the government and the business community.

HOW OUR BANKING SYSTEM OPERATES

There are two kinds of commercial banks in this country: state and national. The national banks are created under Federal laws and are directly regulated by the Federal government. State banks are created under state laws, but even these banks are limited to such an extent by Federal laws that it is erroneous to assume that each state is free to introduce any kind of banking procedure that it desires. The state may have considerable power in saying what a state bank *can* do, but the Federal government has a very definite voice in designating what the state banks *cannot do.*

FUNCTIONS PERFORMED BY COMMERCIAL BANKS

Since money and credit are necessary to the successful operation of modern business, banks are indispensable institutions. Commercial banks perform many valuable services to the businessman and to the general public.

The four main functions performed by the commercial bank are as follows:

1. It provides a safe depository for surplus funds.
2. It makes loans to both business firms and consumers.
3. It serves as an agency through which obligations can be paid by check.
4. It gives valuable financial advice to investors, borrowers, and administrators.

THE FEDERAL RESERVE SYSTEM

Our banking system is coordinated and facilitated through the Federal Reserve System. This system was created in 1913 by act of Congress. The plan provides for the organization of 12 banks located at convenient points throughout the country. The territory covered by each of these banks is called a *Federal reserve district,* and these districts are numbered. The headquarters of each of these districts is as follows:

Atlanta (6)
Boston (1)
Chicago (7)
Cleveland (4)
Dallas (11)
Kansas City (10)
Minneapolis (9)
New York (2)
Philadelphia (3)
San Francisco (12)
Richmond (5)
St. Louis (8)

These reserve banks serve extremely useful purposes for our banking system and have great powers for good or evil in connection with our system of money and credits. They serve as general depositories and clearinghouses for all our national banks and for state banks that meet the requirements. They can lend money to banks, rediscount various commercial papers, and, to a prescribed extent, issue paper money. On the whole their chief functions are to facilitate the normal operations of banks, to distribute wisely available money and credits, and to maintain bank credit and money circulation at wholesome levels.

SUMMARY

Modern business could not be conducted without some kind of medium of exchange. The traditional medium of exchange is money, but in recent times bank deposits subject to checks have largely taken the place of money, especially in connection with the larger business transactions.

Money itself has gone through several stages. Today, in most parts of the world, money consists of paper certificates backed up by little more than the general credit of the government. Properly administered, this system works satisfactorily, but it probably opens up greater opportunities for wild inflation than was the case when the world was definitely on either a gold or silver standard.

Extreme inflation or deflation are both economic evils. Inflation results in gross inequities and a false sense of prosperity that must eventually change into more or less ruinous deflation. Deflation means sudden falling of prices that will lead to loss of business confidence, widespread insolvency, closing of enterprises, and general unemployment.

The operation of banks is facilitated and coordinated by means of the Federal Reserve System. There are 12 Federal reserve banks in this country located at convenient geographical centers.

QUESTIONS FOR REVIEW

1. Would you say it is possible to "buy money on credit"?
2. Give a definition of money.
3. Why is a personal promissory note not to be considered as money?
4. Is a bank note money? How about a treasury note?
5. How did money come into use in the first place?
6. What are the most "standard" metals used for monetary purposes?
7. What is meant by coinage?
8. Explain how debasing money is actually a form of inflation.
9. Explain the part that early goldsmiths played in development of the idea of the use of credit as a form of money.
10. What is the general meaning of the term *gold standard?*
11. What seems to be the status of the gold standard in most countries today?
12. Why are we willing to accept the government's promise to pay (note) as money?
13. Explain the usual functions (services) of a commercial bank.
14. Can banks cause credit either to expand or contract?
15. What significance attaches to the ratio between bank deposits and the cash on hand in bank vaults? Explain this in some detail.

16. What seems to be the "source," or cause, of most bank deposits?
17. What is the purpose of a "clearinghouse"?
18. What is inflation? What usually causes it? May it be permanent?
19. Is it possible for money to become practically worthless owing to inflation?
20. Why is relative stability to be considered a wholesome condition of price level?
21. What is meant by a reserve requirement? How is it related to the expansion of bank credit?
22. To what extent may state banks be considered to be under Federal law?
23. Name the twelve cities in which Federal reserve banks are located.
24. In general what are the functions of the Federal reserve banks?

TERMS AND PHRASES TO DEFINE OR EXPLAIN

1. Money
2. Credit
3. Promissory note
4. Treasury note
5. Bank note
6. Barter
7. Goldsmith
8. Shekel
9. Coinage
10. Baser metals
11. Inflation
12. Gold standard
13. Commercial bank
14. Personal check
15. Bank deposits
16. Loans and discounts
17. Cash
18. Clearinghouse
19. Circulation of money
20. Federal Reserve System
21. Federal reserve district

QUESTIONS FOR DISCUSSION

1. To whom might a bank grant credit?
2. When a businessman pays for goods with a personal check, is he actually using cash or credit?
3. Would you say that *barter* encouraged or discouraged one to enter business as a means of making a livelihood?
4. Which of the following would be most serviceable to business: barter; sheep as a medium of exchange; gold only as a medium of exchange; money and credit as a medium of exchange?
5. Which of the following do you think might bring inflation quickest: debasing the money; uncontrolled printing of paper money; failure to provide sufficient goods for the people?

6. A goldsmith might accept money for safekeeping without charging for his service and still make a profit on the transaction. How could he do it?
7. What reasons might cause banks to expand bank credit? Likewise, what reasons might cause them to contract bank credit?
8. Who is likely to profit most from an inflationary trend? Who is likely to profit least, or actually to suffer?
9. Who is most likely to profit and who is most likely to suffer from a deflationary trend?
10. Can you see any way in which the 12 Federal reserve banks may assist in maintaining a relatively stable price level?

CASE PROBLEMS

1. Back in the days of barter, Stenius has a cow he does not want, but would like to secure a pet kitten for his daughter. He knows that his friend Plenomat wishes to secure a cow but has a pet kitten which he no longer desires. How might Stenius go about making a *fair* trade with his friend?
2. In the preceding case, assume that sheep were quite readily accepted as a medium of exchange. In what way might this change your answer?
3. King Bitrillocco ruled over a small island in the South Sea. His people had almost no contact with the rest of the world but had developed some specialization of labor and were using tobacco as a medium of exchange. Owing to a disease affecting tobacco plants one year the crop for that year was almost completely destroyed. How do you suppose this affected the "price" of other commodities on the island?
4. In due course of time the United States government will have war loans coming due. Suppose that the government should decide to pay them in cash as they become due by printing unlimited quantities of paper money. What effect do you think this would be likely to have on the general price level here?
5. Very shortly after the end of the First World War, John Paulson inherited $10,000. Mr. Paulson had always been a day laborer, but now he decided to become a businessman. He invested the $10,000 in a retail business having a complete stock of goods on hand. The business had been making a nice profit, although before the war it was not doing well and could have been purchased for around $5,000. On the basis of these few facts and your knowledge of business, do you think he did a wise thing?

6. The board of directors of the Trenton State Bank decides the bank should lower the rate of interest it charges borrowers. As a result its loans (and consequently its deposits) increase many times. If this situation is typical of banks throughout the country, what effect will such a trend likely have on the general price level?
7. In the preceding case, what circumstance or set of circumstances might later result in a decrease in the outstanding loans (and the deposits) of this bank?
8. Mr. Whitford grows, processes, stores, and then sells hybrid seed corn. He must hire several hundred workers during the summer and fall and pay them cash, but he has no income from which to pay them until spring. How would you suggest that he finance his unusually large summer and fall expenses?

SUGGESTED PROJECTS

1. Give a brief report to the class on early types of money.
2. Find out what kinds of paper money circulate freely today.
3. Find out from a local banker just how he "clears" checks on other banks.
4. Get information from a local banker concerning the following:
   - *a.* How to open a checking account. How to make future deposits to it.
   - *b.* How to open a savings account. Will interest be received on it?
   - *c.* How to secure and use a safe-deposit box. What rate is charged?
5. Secure a blank check from a local bank. Note the numbers imprinted thereon. Report on the meaning and significance of these numbers.
6. Consult a current issue of the magazine *Banking* and/or *Banking Law Journal*, or other magazines suggested by your instructor, and see how many topics you can find directly related to the content of this chapter.

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6. Insurance

PREVIEW: Business activities are beset by risk and uncertainties. These risks are many and varied. If it were not for the fact that provision for some of these contingencies can be made through insurance, many would hesitate to embark upon business ventures. The profit system is closely allied with economic risks.

What are some of the risks and uncertainties that confront business? How can provision be made for avoiding possible financial losses from these uncertainties?

BUSINESS HAS MANY RISKS

We have repeatedly stated that one of the prices of progress is the taking of risks. When a person embarks upon a certain business venture, he can seldom feel quite sure about the outcome. He does not know how much he will be able to sell or precisely what prices he will get for his products. He can estimate his expenses, but he cannot be sure how close his estimates will be to future realities. Finally, unexpected competition, changes in buying habits, or the emergence of a general business depression may operate to render impossible the future conduct of the business.

In addition to the foregoing general risks the businessman faces the contingencies of losses of a more specific nature. Fires, floods, and tornadoes may destroy his property. Illness may prevent him from taking an active part in his business. He may become involved in a damage suit, which may result in his paying out a considerable portion of his accumulated savings. A trusted employee may run away with most of his money. Finally the death of the proprietor or one of his associates may have a disruptive effect on the business.

SOME RISKS MAY BE PASSED ON TO OTHERS

In many instances a man may relieve himself of some of his risks by paying someone else an agreed sum to assume responsibility for them. This procedure is called *insurance.* We cannot completely eliminate risks, but there are some that may be shifted to others. In such cases a person has the choice between continuing to take the chance of loss himself or making a periodic payment for being relieved of this particular contingency.

There are many risks against which a person cannot take out insurance. For example, in this country at least, a person cannot insure against losses incurred from lack of business ability, deficient consumer demand, deflation, etc. In general a person cannot insure against his own general inefficiency or against anything that is largely speculative or indeterminable as to the probable loss expressed in monetary terms. Finally insurance companies refuse to assume some types of risks because of the difficulty in connection with the proof of loss. In certain instances the insurers would have to rely almost completely upon the testimony of the insured. Willingness to do this would require a greater faith in human nature than most people possess.

INSURANCE INVOLVES DISTRIBUTION OF RISK

The detailed study of insurance involves a vast and complicated subject. The fundamental principle of insurance can be stated briefly and simply: *Insurance is the distribution of risk.* Insurance does not prevent a contingency from happening, but, when a loss does occur, it divides the loss among many and thus prevents it from falling, with sometimes calamitous effect, upon one individual or business.

Let us assume that there are 1,000 persons, each of whom owns a house worth approximately $8,000. They agree that, if anyone in the group suffers a loss from fire, the others will contribute pro rata to make up the loss. During the year the total fire losses amount to $20,000. The average collection for making this good would be

$20 from each of the 1,000 members. To this should be added a small amount for the expenses of conducting the enterprise. A variation of the foregoing plan would be to build up a fund in advance, based upon loss expectancy. This plan would certainly make each person feel more assured of collecting for the losses when they might occur.

INSURANCE HANDLED BY PROFESSIONAL COMPANIES

The illustration given above is so simplified that it may seem not to fit in at all with present-day realities. However, the illustration does show the main points involved, and in the early days of insurance there were instances when insurance service was carried on almost exactly in the manner described. Today nearly all insurance is handled by *insurance companies.* These companies are conducted on the basis of definite and conservative plans and are closely regulated by the laws of the various states. These companies may be conducted for profit or they may be cooperative or *mutual.* Both classes of companies operate successfully, and, except for some variation in the distribution of earnings, their practices and procedures are essentially the same.

There are many kinds of insurance, and naturally the procedures vary to suit the needs of each type. However, they all have at least two things in common:

1. They all build up *reserves* to provide for future losses.
2. Premiums (the charges made for the insurance) are determined on a scientific basis.

Some of the early insurance organizations, usually of the fraternal type, employed the *assessment plan* for levying premiums. This meant that premiums were adjusted from time to time to meet current losses. No definite plan was adopted for meeting possible future losses of extraordinary amounts. Insurance companies now employ the *reserve plan.* This means that the premiums are of a fixed amount, and sufficient resources are kept on hand at all times to meet any losses that might reasonably be expected to occur. At times the assessment plan might be a little cheaper for the insured, but the greater degree of safety provided by the reserve plan is well worth the difference in cost.

The determination of premiums to be paid under the reserve plan is not mere guesswork. It is calculated scientifically on the basis of past experience. In fire insurance, for example, if it is found that 1/4 of 1 per cent of all property is destroyed by fire every year, the rate per $1,000 of property would be $2.50, plus some added charges for expenses and a small margin for profit and added security.

THE INSURANCE POLICY

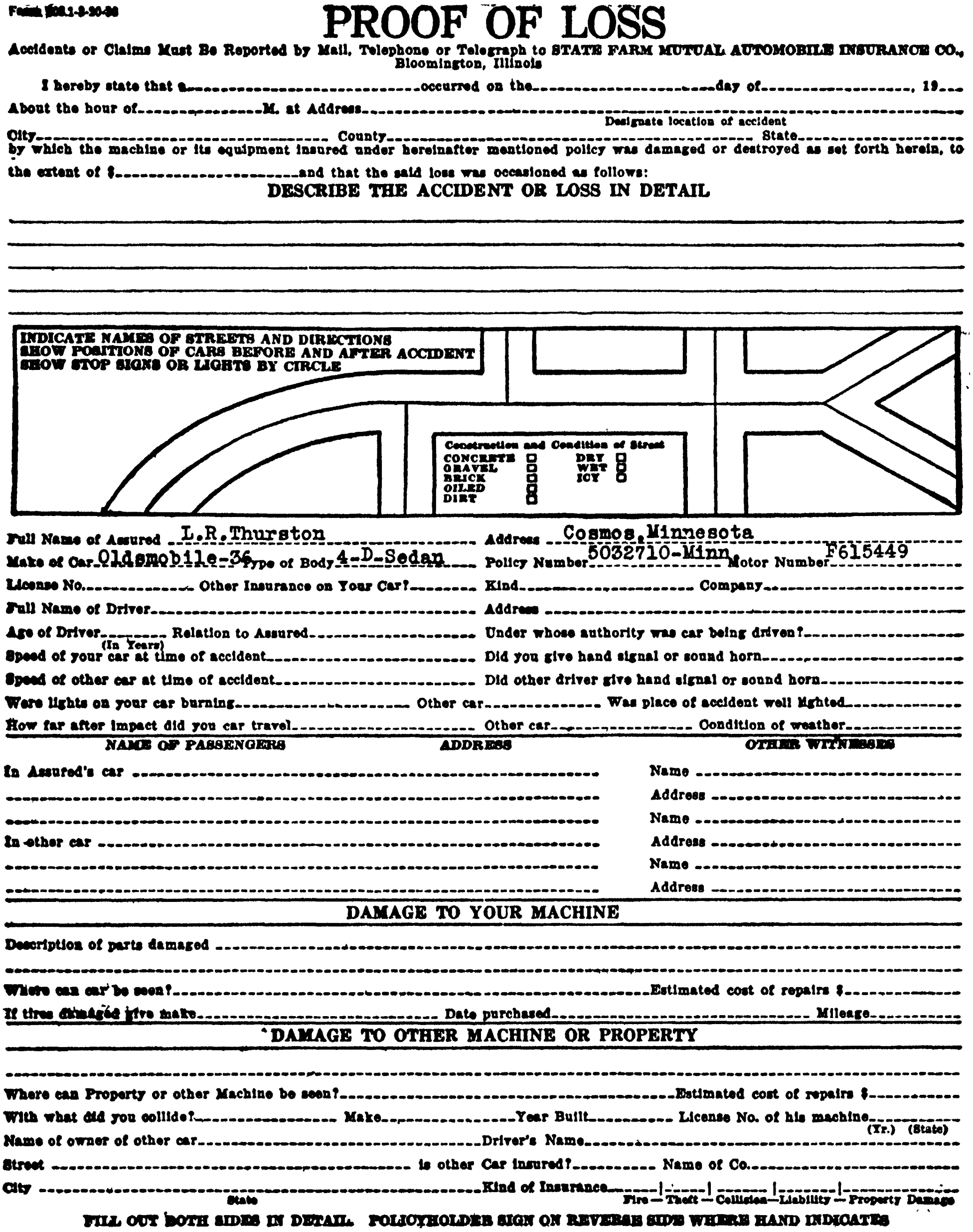
The written agreement of insurance is called an *insurance policy.* An insurance policy may be defined as a contract whereby one person or company (the insurer) undertakes to indemnify another (the insured) against loss caused by the occurrence of a certain specified event. In connection with the insurance policy there are a few definitions that should be learned:

1. *Premium.* The periodic payments made by the insured for his protection.
2. *Subject matter.* The thing insured, such as a house, a car, or a stock of goods.
3. *Risk.* The event insured against, such as fire, tornado, or theft.
4. *Beneficiary.* The person to whom the amount stated in the policy is to be paid in case of loss.
5. *Open policy.* A policy in which the amount to be paid in case of loss is not stated in the policy, as in automobile insurance.
6. *Valued policy.* One in which the amount to be paid to the insured is definitely stated in the policy. Life-insurance contracts are examples of this type.

The execution of insurance policies is governed by state laws and must be done with great care. The highest type of good faith must be exercised, both by the insurer and the insured. An intentional or careless misstatement of a material fact by the insured may make the policy void.

WHAT TO DO WHEN LOSS OCCURS

When insured property is damaged or destroyed, the insured must immediately notify the insurance company or its duly authorized agent. This must be followed by a *proof of loss.* The amount to be paid will then be a matter of negotiation between the insurance company and the insured, based on the terms of the policy.



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PROOF OF LOSS

Accidents or Claims Must Be Reported by Mail, Telephone or Telegraph to STATE FARM MUTUAL AUTOMOBILE INSURANCE CO.,
Bloomington, Illinois

I hereby state that a .... occurred on the .... day of ...., 19...
About the hour of .... M. at Address ....
Designate location of accident
City .... County .... State ....
by which the machine or its equipment insured under hereinafter mentioned policy was damaged or destroyed as set forth herein, to the extent of $ .... and that the said loss was occasioned as follows:

DESCRIBE THE ACCIDENT OR LOSS IN DETAIL

INDICATE NAMES OF STREETS AND DIRECTIONS
SHOW POSITIONS OF CARS BEFORE AND AFTER ACCIDENT
SHOW STOP SIGNS OR LIGHTS BY CIRCLE

Construction and Condition of Street
CONCRETE ☐ DRY ☐
GRAVEL ☐ WET ☐
BRICK ☐ ICY ☐
OILED ☐
DIRT ☐

Full Name of Assured L.R.Thurston Address Cosmos,Minnesota
Make of Car Oldsmobile-36 Type of Body 4-D-Sedan Policy Number 5032710-Minn. Motor Number F615449
License No. .... Other Insurance on Your Car? .... Kind .... Company ....
Full Name of Driver .... Address ....
Age of Driver .... (In Years) Relation to Assured .... Under whose authority was car being driven? ....
Speed of your car at time of accident .... Did you give hand signal or sound horn ....
Speed of other car at time of accident .... Did other driver give hand signal or sound horn ....
Were lights on your car burning .... Other car .... Was place of accident well lighted ....
How far after impact did you car travel .... Other car .... Condition of weather ....

NAME OF PASSENGERS	ADDRESS	OTHER WITNESSES
In Assured's car		Name
		Address
		Name
In other car		Address
		Name
		Address

DAMAGE TO YOUR MACHINE

Description of parts damaged ....
Where can car be seen? .... Estimated cost of repairs $ ....
If tires damaged give make .... Date purchased .... Mileage ....

DAMAGE TO OTHER MACHINE OR PROPERTY

Where can Property or other Machine be seen? .... Estimated cost of repairs $ ....
With what did you collide? .... Make .... Year Built .... License No. of his machine .... (Yr.) (State)
Name of owner of other car .... Driver's Name ....
Street .... Is other Car insured? .... Name of Co. ....
City .... State .... Kind of Insurance ...... | ...... | ...... | ...... | ...... Fire — Theft — Collision — Liability — Property Damage

FILL OUT BOTH SIDES IN DETAIL. POLICYHOLDER SIGN ON REVERSE SIDE WHERE HAND INDICATES

PROOF-OF-LOSS FORM.

If the insured is not guilty of any material misrepresentations and if he follows the procedures specified in the policy, he will be in a position to collect. Unless a provision in the policy is violated, this is true even if the loss was due to his own carelessness. There are in general only four instances when the insured cannot collect:

1. If he made a material misrepresentation of the facts.
2. If he failed to give proper notice and proof of loss.
3. If he violated the terms of the policy.
4. If he himself caused the loss by a deliberate act.

DIFFERENT TYPES OF INSURANCE

There is a considerable variety of insurance depending upon the specific risks insured against, but they may all be grouped under the following general classes:

Life. This is essentially a promise to pay a certain sum to the insured's beneficiary in event of the former's death.

Personal health and safety. This includes the various kinds of health, accident, and hospitalization policies. If a person is willing to pay the price, he can eliminate nearly every chance of money loss from these sources.

Property. This includes all policies having to do with protection against property losses. Important examples are insurance against fire, tornado, earthquakes, theft, and collisions.

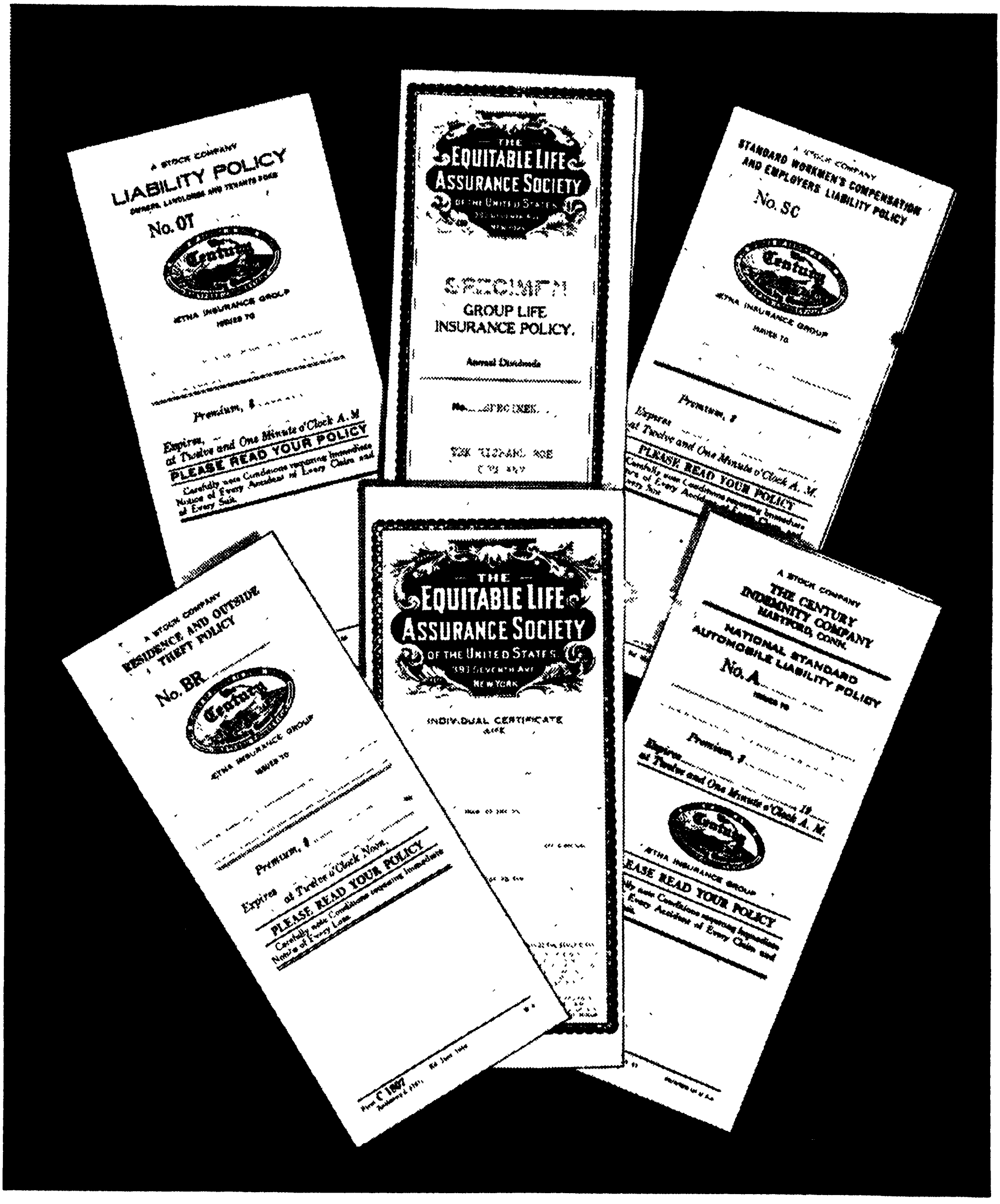
Fidelity. This involves insurance against losses resulting from other people's dishonesty. An outstanding example is the bonding of trustees and employees.

Liability. This protects a person against certain damage suits. The contract provides that if a damage claim is brought against the insured, the insurance company will step into his place, finance his defense, and pay any damages the other person may rightfully collect up to the amount specified in the policy.

Unemployment. Insurance against the contingency of unemployment is not undertaken by the regular commercial insurance companies. It is largely carried on by the government. Under the Social Security Act and laws in many states, this kind of insurance has gone a long way toward becoming compulsory. Many large private companies have plans of their own providing either unemployment benefits or assurance of constant work over a period of time.

INSURANCE IMPORTANT FOR BUSINESS

Some people think of insurance as being of importance chiefly to individuals. It should not be forgotten that insurance is an important element in safeguarding against contingencies that may be classed as *business risks*. As a matter of fact a business concern may well make use of all the types of insurance mentioned above.


LIABILITY POLICY
No. OT
THE EQUITABLE LIFE ASSURANCE SOCIETY OF THE UNITED STATES
GROUP LIFE INSURANCE POLICY
STANDARD WORKMEN'S COMPENSATION AND EMPLOYERS LIABILITY POLICY
No. SC
RESIDENCE AND OUTSIDE THEFT POLICY
No. BR
THE EQUITABLE LIFE ASSURANCE SOCIETY OF THE UNITED STATES
393 SEVENTH AVE NEW YORK
INDIVIDUAL CERTIFICATE
THE CENTURY INDEMNITY COMPANY HARTFORD, CONN.
NATIONAL STANDARD AUTOMOBILE LIABILITY POLICY
No. A
PLEASE READ YOUR POLICY

SEVERAL DIFFERENT KINDS OF POLICIES.

Life insurance from the viewpoint of an individual will be discussed in a later chapter, and no further description of this important type of insurance will be presented here. However, we should call attention to the fact that this kind of insurance may have high value to a business concern as such. Life insurance is frequently carried on the members of a partnership or on some outstanding officers in corporations. Frequently life insurance is carried on a debtor. This is especially true when the payment of the debt should be jeopardized in the event of the death of the debtor.

Health and accident insurance on members of a partnership or corporation may not seem directly to benefit the business concern involved. Nevertheless the assurance of continued income for such persons in times of disability may at times be of at least indirect value to the business concerns that they represent.

The most important protection from a business standpoint is property insurance. Most businesses have some investment in property, and in many cases the destruction of all the property would mean insolvency and the discontinuance of the business. The only safe alternative to insurance would be to build up an "insurance fund" as a reserve. Under most circumstances this is uneconomical, since it would involve the necessity of tying up too much capital. However, an extensive railway system might conceivably maintain its own property without insurance.

Business firms as well as individuals may become involved in damage suits. They may, for instance, become liable to customers and others who are injured on the premises due to the neglect of providing proper safeguards.

In other cases liability to third parties may result from the negligence or misconduct of an employee who is at the time working for the company. The most important form of liability insurance is *workmen's compensation insurance.* This is taken out by employers for the purpose of indemnifying employees who are injured in connection with their employment. For a more complete explanation of this kind of insurance, see Chapter 28.

Fidelity insurance is of considerable importance to business. Certain forms of insurance of this type protect the business against loss from embezzlement. An important application of fidelity insurance is the bonding of employees and others who are responsible for money and property belonging to the business.

SUMMARY

People who engage in business assume a great number of risks. The nature of some of these risks is such that the businessman must carry them himself. Other risks may be passed on to insurance companies whose business it is to assume certain specified risks for a consideration called a *premium*. Insurance does not eliminate the risk. It merely makes it possible to distribute the losses among many and thus prevent them from falling with disastrous effects upon a few. We may therefore say that the function of insurance is the distribution of risks.

There are many types of insurance, and these may be listed in general as follows:

1. Life insurance
2. Personal health and safety insurance.
3. Property insurance
4. Fidelity insurance
5. Liability insurance
6. Unemployment insurance

All these types of insurance are of importance to business as well as to individuals. Unemployment insurance is either furnished by the government or is provided by the employers themselves. The other types of insurance are furnished by companies organized for that purpose.

Insurance is now closely regulated by law, and a high degree of good faith and honesty must be exercised by the contracting parties. The insured must be careful to avoid any material misrepresentations and must carefully comply with the terms of the policy. Failure to do this may result in rendering the policy void.

QUESTIONS FOR REVIEW

1. What are some of the risks that commonly make the outcome of a business venture uncertain?
2. A businessman may relieve himself of many risks by paying some-

one else to assume them. This is insurance. Name several types of risks for which the businessman cannot get insurance, however.

3. Does insurance prevent contingencies from happening?
4. Explain what is meant by the statement, "Insurance is the distribution of risk."
5. Are insurance companies operated for profit? Are they sometimes essentially a cooperative undertaking?
6. Why do insurance companies build up reserves?
7. What is meant by a premium?
8. Why is the premium plan much more common today than the assessment plan?
9. How might an insurance company go about deciding upon the amount of the premium to be charged?
10. In general, what is included in an insurance policy? Distinguish between the subject matter and the risk. Who is the beneficiary? Distinguish between open and valued policies.
11. Why is it important that the insured use great care in the statement of all facts in securing an insurance policy?
12. What four causes, in general, may prevent the insured from collecting for a loss covered by an insurance policy?
13. Name and identify the six general classes of insurance.
14. Which of these six classes of insurance may well be used by business?
15. Which type of insurance is perhaps most important for business?
16. What is workmen's compensation insurance?
17. What is meant by fidelity insurance?

TERMS AND PHRASES TO DEFINE OR EXPLAIN

1. Insurance
2. Contingencies
3. Mutual companies
4. Reserve
5. Assessment plan
6. Policy
7. The subject matter
8. Valued policy
9. Risk
10. Premium
11. Fidelity insurance
12. Workmen's compensation insurance
13. Material misrepresentation
14. Personal health and safety insurance
15. Unemployment insurance
16. Distribution of risk
17. Stock companies
18. Beneficiary
19. Open policy
20. Proof of loss
21. Life insurance
22. Property insurance
23. Liability insurance

QUESTIONS FOR DISCUSSION

1. To what extent does greater risk in a given business undertaking assure greater profit? Could greater risk be interpreted as evidence of the probability of greater loss?
2. It has been said that college education is itself a form of insurance. What do you think about it?
3. How can an insurance company afford to take a given risk any better than the owner of the business could afford to do so?
4. Why do we not have companies offering to insure against "inability to arrange a suitable marriage"?
5. How many separate "insurers" would seem to be necessary in order to satisfactorily distribute a risk through insurance?
6. Would it seem wise for a fire-insurance company to "specialize" on the insurance of property in only one town or city or county?
7. The "assessment plan" is no longer widely used. Can you think of probable reasons for its decline in importance?
8. Today the death rate per 1,000 of population is considerably lower than it was a century ago. How might this affect life-insurance premiums?
9. Mention some business situations that you think might involve a risk that might be transferred to others through the use of fidelity insurance.

CASE PROBLEMS

1. In the early part of 1946 Mr. C. H. Johnson was considering whether or not to open a new privately operated business college. He was positive he had some unusually good ideas for training secretaries and knew that he was properly equipped in training and experience to do an excellent job preparing secretaries. He had the necessary capital available and an option on a building ideally suited to his needs. His one big risk seemed to be whether or not he would be able to get sufficient students. He was not sure whether enrollments in such schools would increase during the postwar period or not, and he didn't know whether or not other competitors might start operating new schools. Is there any way he can insure against this risk of insufficient students?
2. Mr. Paul Moon has decided to open a department store. In making preparations for it he lists a large number of risks that he knows he will have to face. Here are a few of them. For which of these

can he secure insurance and what kind of insurance would it be in each case?

a. Goods may be destroyed by fire.
b. The automatic sprinkler system may destroy goods in preventing the spread of fires.
c. Goods may become torn, dirty, and shopworn.
d. Goods placed in show windows may fade and become worthless.
e. Customers and others may accidentally break expensive plate-glass windows and other expensive fixtures.
f. Fresh fruits, meats, etc., may spoil.
g. Customers in the store may hurt themselves on the escalator, the stairs, or otherwise and bring suit for damages.
h. Cashiers, auditors, and others entrusted with cash may steal it.
i. Salespeople may give out too much change, pilfer the cash register, or appropriate merchandise for their own use.
j. Customers charging goods may fail to pay for them.
k. Employees may get hurt while at work and bring suit for damages.
l. Employees may cause personal injury to customers or others, who in turn may sue the company for damages.
m. He may unintentionally violate any one of hundreds of laws and regulations and be subjected to a payment of a fine.

SUGGESTED PROJECTS

1. Report to the class on the law of your state regarding workmen's compensation insurance.
2. Investigate and report on typical rates charged for fidelity insurance.
3. Investigate and report to the class on various factors that are considered in setting the rate on fire insurance on buildings.
4. Investigate and report to the class the meaning and purpose of an 80 per cent coinsurance clause.
5. Interview several proprietor-owners of different types of businesses and inquire as to the different types of insurance used in their respective businesses. Possibly some will be willing to tell you the approximate monthly or annual premiums they pay. Report to the class.

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7. Business information

PREVIEW: This is an age of scientific procedure in business. A business that does not operate on the basis of extensive and reasonably exact information is in danger of losing out in the race for economic success. The day when business could succeed on the basis of hunches and more or less haphazard experimentation is definitely a thing of the past. The information available to business is of a multitudinous nature and comes from a variety of sources. What is the nature and what are the sources of business information? How can the businessman make the best use of this information?

THE NEED FOR INFORMATION

A certain minimum amount of information is indispensable to business. There are legal rules and regulations pertaining to business of which businessmen must be cognizant. Taxes must be determined; reports must be made; rules with respect to employees and others must be observed.

Beyond these minimum requirements, information is valuable in a variety of ways. Knowledge of the present market, forecasts about the future, appraisal of competitive conditions, information about improved business methods, facts about markets and about sources of supplies—these are examples of information that every alert businessman should seek.

SOURCES OF INFORMATION

Few businessmen are aware of the many sources of valuable information that are available to them. Still fewer make use of all the published information that may be of value in their particular business. This chapter is not a complete compendium of the various sources of business information, but it will give the student some idea of the vast scope of such information available and can be used as a starting point for further investigation. The sources of business information may be broadly classified as follows:

1. Federal government
2. State and local governments
3. Private

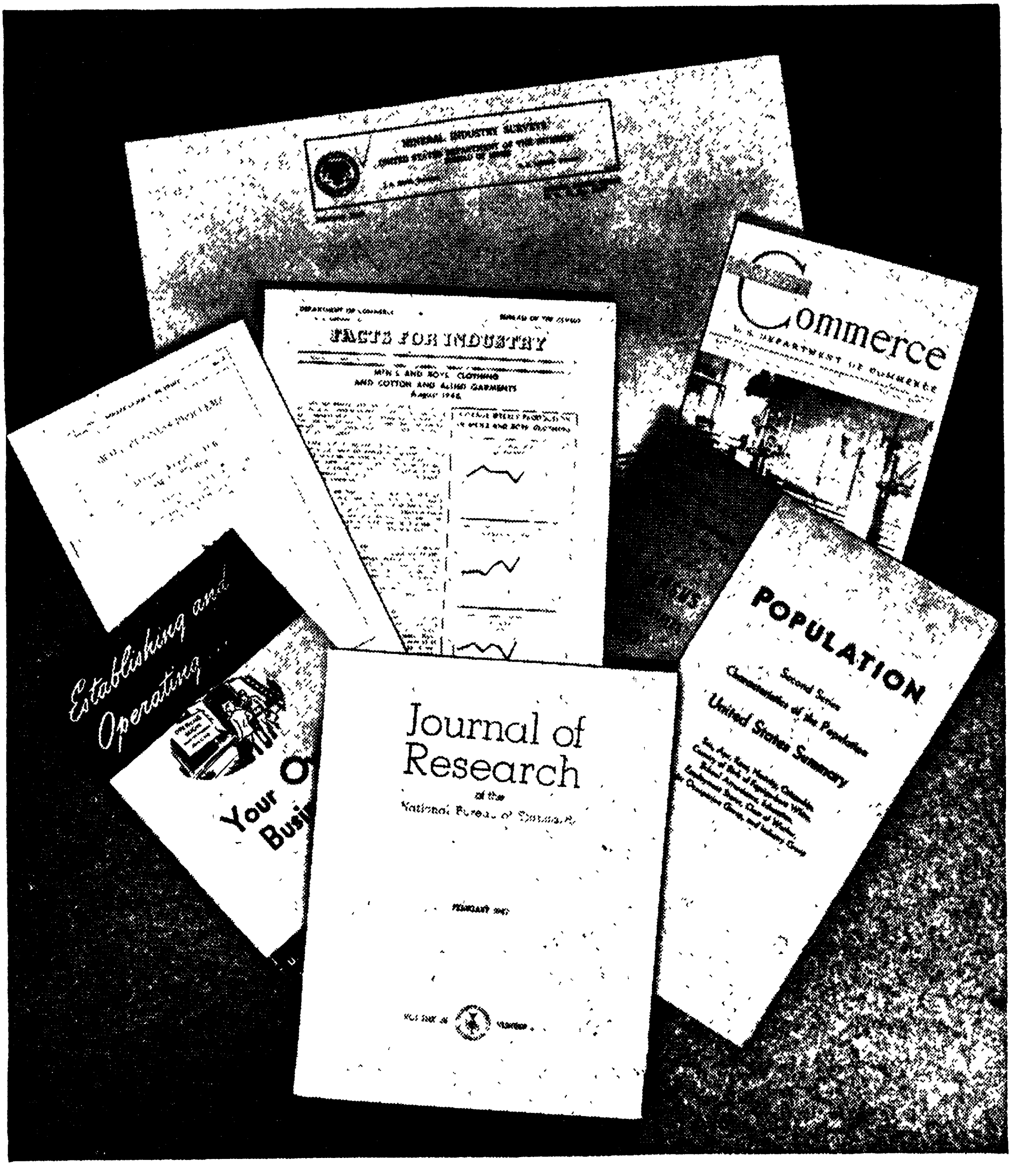
These sources of information will now be considered in the order mentioned.

INFORMATION FURNISHED BY THE FEDERAL GOVERNMENT

The Federal government, through its various departments, boards, and commissions, is the best single source of business information. This is true from the standpoint of quantity, variety, and reliability. Some of this service is given in the form of advice to specific parties. Most of it consists of a profusion of publications dealing with the technical, statistical, and legal aspects of American business.

In its direct advisory and informational service to business, the Department of Commerce holds a prominent place. For instance, its Bureau of Foreign and Domestic Commerce maintains more than thirty district offices in different parts of the country. An important function of these offices is to furnish consulting service to businessmen.

Numerous examples could be quoted to show the importance of this advisory service. A person who wishes to locate a factory may receive comparative data regarding markets, materials, labor, power, transportation, and real-estate values. A prospective exporter may get data concerning possible foreign markets. Those who wish to study the domestic market will be furnished with specific information regarding laws, customs, buying power, climate, and anything else that has a bearing upon the determination of potential markets.


FACTS FOR INDUSTRY
Commerce
Establishing and Operating
Your Own Business
Journal of Research
POPULATION
United States Summary

SEVERAL DIFFERENT KINDS OF BULLETIN.

In addition to this more individualized advisory service, the bureau provides library facilities in the district offices. In these libraries are contained the bureau's own published information and also other valuable source materials.

The Department of Commerce has other bureaus that are sources of information. The most important are the following:

1. The Bureau of Standards. Serves people who need information concerning testing and grading of goods.
2. Bureau of Mines. Carries on research work in mining.
3. Bureau of the Census. Is responsible for most of the statistical data furnished by the government.

THE DEPARTMENT OF AGRICULTURE

The information and advisory service of the Department of Agriculture is designed chiefly for farmers. It carries on extensive research work in animal husbandry, plant life, and chemistry of the soil. It seeks to rid the country of insect pests, plant and animal diseases, and other conditions adversely affecting American agriculture. The department also deals with the economic aspects of farming, such as transportation, markets, financing, and cooperatives.

However, the Department of Agriculture is of interest also to others than farmers. Agricultural information is important to many businessmen. Furthermore the department maintains bureaus that issue information of value to a variety of enterprises.

THE DEPARTMENT OF LABOR

The fact-finding and advisory functions of the Department of Labor are of value to business executives as well as to labor. Of greatest importance are the statistics and other data concerning employment, occupations, hours, wages, and labor legislation. Closely connected with these are facts and decisions emanating from the National Labor Relations Board. Most of this information is useful for all people employing large groups of employees. Much of it, such as labor regulations, is indispensable for keeping employers from becoming violators of some law.

MISCELLANEOUS FEDERAL SOURCES

The mere listing and brief description of the various types of information furnished by the different Federal departments, boards, and commissions would cover a great number of pages and would be of little value to the average reader, since a list of topics covering any field in which you may be interested can be secured by writing to the Government Printing Office, Washington, D.C. A few of the outstanding sources not already mentioned are listed below:

1. Postal Department. Postal regulations and information concerning costs and speed of mail shipments.
2. Treasury Department. Information concerning all forms of Federal taxes. Statistics concerning national income and the receipts and expenditures of the government.
3. Federal Reserve Board. Reports on banking and business conditions.
4. Interstate Commerce Commission. Revenue and expenses of interstate common carriers, freight rates, wages and hours of railway labor.
5. Federal Trade Commission. Reports on the organization, operation, methods and practices of leading industries.

SOME INFORMATION FROM YOUR STATE GOVERNMENT

The amount of business facts and advice issued by state governments is small compared with that of the Federal government. Nevertheless some information that is unavailable elsewhere may be obtained from this source. The following are important state sources:

1. Tax Department. Laws relating to state taxes.
2. Department of State. Data concerning incorporation, business activities, and franchises.
3. Department of Agriculture. This supplements the work of the Federal Department of Agriculture.
4. Banking and Insurance Commissions. These and other departments and commissions publish reports and bulletins on business, industrial, and agricultural subjects.

Local governments within the state do not issue much published material of general interest. However, much information is available for particular individuals who may be interested. This information covers such things as taxes, information on titles to property, and certain records entered by the local courts.

PRIVATE AGENCIES PROVIDING INFORMATION

The government is by no means the sole source of business information. Many private agencies have been created for that very purpose. Some of these are endowed organizations or are supported by certain voluntary contributions and thus render service at little or no charge. Other agencies are conducted as business enterprises for profit.

If you wish to find out something about the standing of a particular corporation, reference may be made to *Moody's Industrial Manual* or to *Poor's Manual.* Dun & Bradstreet, Inc., offer you current information on the credit rating of the various business concerns, large or small, in the country. If marketing information is what you want, refer to such publications as *Market Guide, Study of All American Markets,* and the various directories and mailing lists prepared by concerns organized for that purpose. Examples of these are Boyd's City Dispatch, the Reuben H. Donnelley Corporation, and the Dartnell Corporation.

Aside from agencies providing special information as explained above, there are some that devote their chief attention to giving general facts concerning business conditions and trends. Examples of these are the Brookmire Economic Service, Inc., Standard Trade and Securities Service, the Harvard Economic Service, and Babson's Reports, Inc. These fact-finding and reporting services help business executives to plan their businesses in the light of present business conditions and probable future trends.

USE BUSINESS INFORMATION AS NEEDED

The very existence of such an abundance and variety of published business information may leave the student with a feeling almost akin to frustration. One may well ask, "If I should wish to study this material, how would I go about it?" The answer is that you will refer to this information only to the extent that it serves some useful, predetermined purpose. Only a small fraction of the total number of topics listed will apply to any particular businessman.

Again, within a given topic, there may be only one or two points a person needs to know. Effective use of business information requires that the individual determine what he needs to know and then make his selection on that basis. Haphazard and aimless reading may be harmless, but it is rather time consuming.

In seeking the information needed, use should be made of the facilities provided by school libraries and public libraries. These institutions can usually furnish guides to most of the business literature in which one may be interested. If it is a large library, much of it may be on hand, but in any case you will be able to find out where to get it. Along this line, most libraries have several guides to periodical literature. Among these are *Poole's Index,* the *Reader's Guide to Periodical Literature,* the *Industrial Arts Index,* the *Industrial Digest,* and the *Public Affairs Information Service.*

SUMMARY

One of the prerequisites of successful business operations is the possession of adequate facts and information. Such material is available in profuse abundance. This information comes from three main sources:

1. Federal government
2. State and local governments
3. Private agencies

The services of this nature offered by governmental and private organizations may be either in the form of specific advice to individuals or groups, or published information available to the public in general.

It is not sufficient to use available business information—it should be used *wisely*. The first step is to determine what your problems are. You should then obtain and study the particular information that may lead to the proper solutions.

QUESTIONS FOR REVIEW

1. Distinguish between the kind of information that is a minimum essential for operating any business and the kind that alert businessmen seek.

2. What probably is the best single source of business information? What other two broad sources are there?
3. In which department of the Federal government is the Bureau of Foreign and Domestic Commerce found? Describe some of its services.
4. Mention three other bureaus within the Department of Commerce that supply much information valuable to business.
5. What information supplied by the Department of Agriculture is of value to business?
6. What business information is available through the Department of Labor?
7. Mention several other sources of information within the Federal government, briefly indicating the nature of the information supplied by each.
8. What type of information might you expect to obtain from each of the following offices within your state government:
    - *a.* The Tax Department
    - *b.* The Department of State
    - *c.* The Department of Agriculture
    - *d.* The Banking and Insurance Commission
9. Why should certain private agencies furnish business information?
10. Name a number of private agencies and publications furnishing business information and briefly indicate the nature of each service.
11. What do the following business services have in common: Brookmire Economic Service, Inc.; Harvard Economic Service; Standard Trade and Securities Service; Babson's Reports, Inc.?
12. Explain how one might best go about making use of the information published by the various agencies furnishing business information.
13. Name several guides to periodical literature that are usually found in public libraries.

TERMS AND PHRASES TO DEFINE OR EXPLAIN

1. U.S. Department of Commerce
2. Bureau of Standards
3. Bureau of the Census
4. Weather Bureau
5. Government Printing Office
6. Treasury Department
7. Interstate Commerce Commission
8. Banking and Insurance Commission
9. *Poor's Manual*

10. *Market Guide*
11. Reuben H. Donnelley Corporation
12. Brookmire Economic Service
13. Standard Trade and Securities Service
14. *Reader's Guide to Periodical Literature*
15. Public Affairs Information Service
16. Bureau of Foreign and Domestic Commerce
17. Bureau of Mines
18. Department of Agriculture
19. Department of Labor
20. Postal Department
21. Federal Reserve Board
22. Federal Trade Commission
23. *Moody's Industrial Manual*
24. Dun & Bradstreet, Inc.
25. Boyd's City Dispatch
26. Dartnell Corporation
27. Harvard Economic Service
28. Babson's Reports, Inc.
29. *Poole's Index*
30. *Industrial Arts Index*
31. *Industrial Digest*

QUESTIONS FOR DISCUSSION

1. Why should the government spend large sums compiling and publishing information to assist business? Does it do the same thing for education?
2. Why should the Bureau of Foreign and Domestic Commerce maintain offices in various parts of the country?
3. Will government agencies assist an individual in securing the exact information he desires or will he have to find it for himself by searching for published materials relating to it?
4. Do you think the publications of the Department of Labor are read more by laborers or by employers? Why?
5. Which information do you think is likely to be more accurate and up-to-date, that published by the government or that published by private agencies?
6. Since government publications present actual facts covering about the entire field of business, why wouldn't it be advisable for one wishing to prepare for a business career to spend many hours studying such materials?

CASE PROBLEMS

1. The Peter Frank Manufacturing Company, a large, well-financed manufacturer of heavy machinery, has been financially successful. Its board of directors has been discussing the advisability of considerably expanding its output. Following are a few of the ques-

tions the board is raising. Suggest one or more sources of information to which the board might refer in arriving at an answer to each question.

a. What will the future world demand probably be for heavy machinery?
b. Would it be practical to secure and operate its own coal and iron mines?
c. Where is the most likely foreign market for its product?
d. To what extent have competing industrial concerns been expanding their activities to absorb future demands?
e. What importers in foreign countries might be sufficiently sound financially to serve the company as foreign agents?
f. What will be the effects on the earnings of the company if it should add an export business? How will it affect taxes?

2. Louis Franchetti was born and raised in the tropical areas of Central and South America. Later he came to the southern United States and established a small business importing bananas and certain other tropical fruits. Together with three friends he is now planning to establish a very large importing company with its own wholesale houses strategically located throughout the United States. They would deal in fruits, with emphasis on tropical fruits. What sources might he use in getting information to help arrive at answers to the following problems:

a. Where should these wholesale houses be located?
b. What effects would climatic and weather conditions in various parts of the United States have upon shipments of fruit?
c. What would be the most economical methods of shipping the fruits over the United States, everything considered?
d. If they form a corporation, in what state should the charter be secured?
e. If they sell many large shipments on consignment, or on credit, how can they be sure the purchasers are financially sound?
f. What research has been conducted relative to methods of storing, refrigerating, and transporting fresh fruits?

SUGGESTED PROJECTS

1. Select some well-known corporation, either nationally known or otherwise, and report such information as you can find relative to

the kinds of stock outstanding, the amount, the market price, and the dividends paid recently.

2. Refer to some forecasting service publications and report on the probable future trends of business activity.
3. Refer to the *Readers' Guide* and report the names of magazines in which articles have appeared during the past year relating to business forecasting.
4. Assign to each member of the class one or more of the terms and phrases appearing in this chapter and have him check the library carefully and report as follows:

   a. A written statement to the instructor indicating materials found.

   b. A brief one-minute oral report to the class on materials found. This oral report should be carefully prepared previously and should aim really to inform the class as to availability of the material.

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STEVENS, W. M.: "Financial Organization and Administration," Chaps. III–XXIII.

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10. *Location* 141

8. Business organization

PREVIEW: If you have $5,000 coupled with the intention to enter into a certain line of business, you must decide upon the particular form of organization your business shall assume. If your $5,000 is approximately all the initial capital your business requires and if you desire to retain the maximum degree of personal independence, you may decide upon going into business alone. This is called a *single proprietorship.* If you want more capital and also wish to have someone with whom to share your duties and responsibilities, you may wish to negotiate with one or more other persons and form a *partnership.* If you want a more complex organization and one that permits of the maximum possibilities of expansion, you may apply to the state for permission to create a *corporation.* These three—single proprietorship, partnership, and corporation—are the basic forms of business organization. Which type of business organization is the best? What are the essential differences?

ALL FORMS ARE IMPORTANT

The single proprietorship is by far the most numerous type of business organization. It is the prevailing form in agriculture and is very common in connection with retailing, service establishments, places of entertainment, and in the professions. From the viewpoint of the relative amount of total business, the single proprietorship has greatly decreased during the last fifty years. Nevertheless this particular form is still important, and in connection with some kinds of enterprises it is often the best type of organization.

Some forms of partnership have existed ever since man first began to carry on fairly extensive trading operations. Partnerships are found in nearly all kinds of business, but they are most common in connection with merchandising and in certain financial and professional enterprises. During the last hundred years partnerships have gradually declined in relative importance, having been largely supplanted by the corporate form. During the past few years the position of partnerships has perhaps been slightly strengthened owing to high taxes on corporate earnings.

The corporation is the most recent form of business organization and has enjoyed by far the most rapid growth both in relative number and in the proportion of the volume of business. Commercial banks, insurance companies, and railroads and other public utilities use this form almost exclusively, and it is the predominating

Importance of Corporate Activity by Branches of Industry in 1937

Industry	*Per cent of national income*	*Per cent of business done by corporations in each industry*
Agriculture	8.9	7
Mining	2.1	96
Electric light and power and manufactured gas	1.6	100
Manufacturing	24.0	92
Contract construction	2.1	36
Transportation	7.3	89
Communication	1.3	100
Trade	12.5	58
Finance	9.3	84
Government—including work relief wages	13.5	58
Service	11.9	30
Miscellaneous	4.2	33

SOURCE: Data used by W. Thorp in testimony before the Temporary National Economic Committee in 1938.

type in large-scale manufacturing. It is very common in connection with the larger mercantile establishments and has even made some progress in the field of agriculture.

BASIC DIFFERENCES BETWEEN PARTNERSHIP AND CORPORATIONS

We need not spend time discussing the legal aspects of the single proprietorship. This form of business organization is governed by all the laws governing individuals as such. In addition to this the single proprietorship must observe the laws that may pertain to the particular business in which it is engaged.

A partnership is an association of two or more persons to carry on as coowners a business for profit. We note from this that there must be at least two persons, they must be coowners, and they must carry on a continuous business for profit. A single venture entered into by two or more persons is not a partnership. Neither is a nonprofit association, like a club, a partnership, since it does not operate for a profit.

Allen and Baker each contribute $10,000 to finance the operation of a retail clothing store. They agree to share profits and losses equally. This is a partnership, since Allen and Baker are coowners of a continuous business conducted for profit.

Carter and Donald each had a farm and specialized in the production of turkeys. In marketing the turkeys, each farmer weighed his turkeys and put them in trucks to send them to market. When the turkeys were sold they divided the proceeds according to weight after deducting transportation expenses. This was a venture and not a partnership, since Carter and Donald were not coowners of a continuous business. When this one transaction was completed, their business relationships ended.

Fifty men bought a tract of land and developed it as a recreation field for themselves and their families. This was an association and not a partnership. A partnership must involve the prospect of monetary profit.

A corporation is an association of persons joined together by legislative authority into one body with capacity to act in many respects as an individual. People who wish to incorporate must apply to the state for permission. Such granting of corporate rights is now governed by statutes in the various states, and, if certain specific requirements are met, the privilege of incorporation is granted. The vast majority of corporations are created under state laws. The Federal government has only a very limited power to grant corporate charters; it does, for example, have such power in connection with the creation of national banks.

The right to act as a corporation was originally granted as a special privilege at the discretion of the issuing authority. In this country the right to grant corporate charters was generally vested in the state legislatures. The consideration of numerous applications for charters was rather wasteful of time. Furthermore there were cases of bias, if not positive unfairness and discrimination, in granting these privileges. For these and other reasons it was finally deemed desirable to lay down specific requirements for incorporation and leave the actual dispensing of charters to an administrative officer, usually the secretary of state. This saved much time, delay, and confusion and resulted in all applicants being treated alike.

From the foregoing definitions and explanations some outstanding differences between corporations and partnerships become apparent. The two most important differences are:

1. Corporations are created by the state. Partnerships are purely a matter of private contracts.
2. Corporations are looked upon as legal entities. Partnerships are considered as a group of individuals. This gives rise to the following specific differences between partnerships and corporations.

Corporation	Partnership
1. Exists in its own name as an individual.	1. Exists as a group of individuals. The members, as such, constitute the partnership.
2. Has continuous existence regardless of change in stockholders.	2. Automatic dissolution arising from death, withdrawal, or incapacity of a partner.
3. Stockholders have limited liability.	3. Each partner has unlimited personal liability.
4. Obligations arise only from the acts of agents or officers.	4. Obligations arise from the acts of any partner.
5. Profits belong to the corporation until dividends are declared.	5. Profits belong to the individual partners as soon as earned.

6. Control by stockholders is indirect.	6. Control of partners is direct and personal.

The rule of unlimited personal liability does not apply to a limited partnership. This form of organization will be briefly explained in a later section.

NO SPECIAL FORMALITY IN CREATION OF PARTNERSHIPS

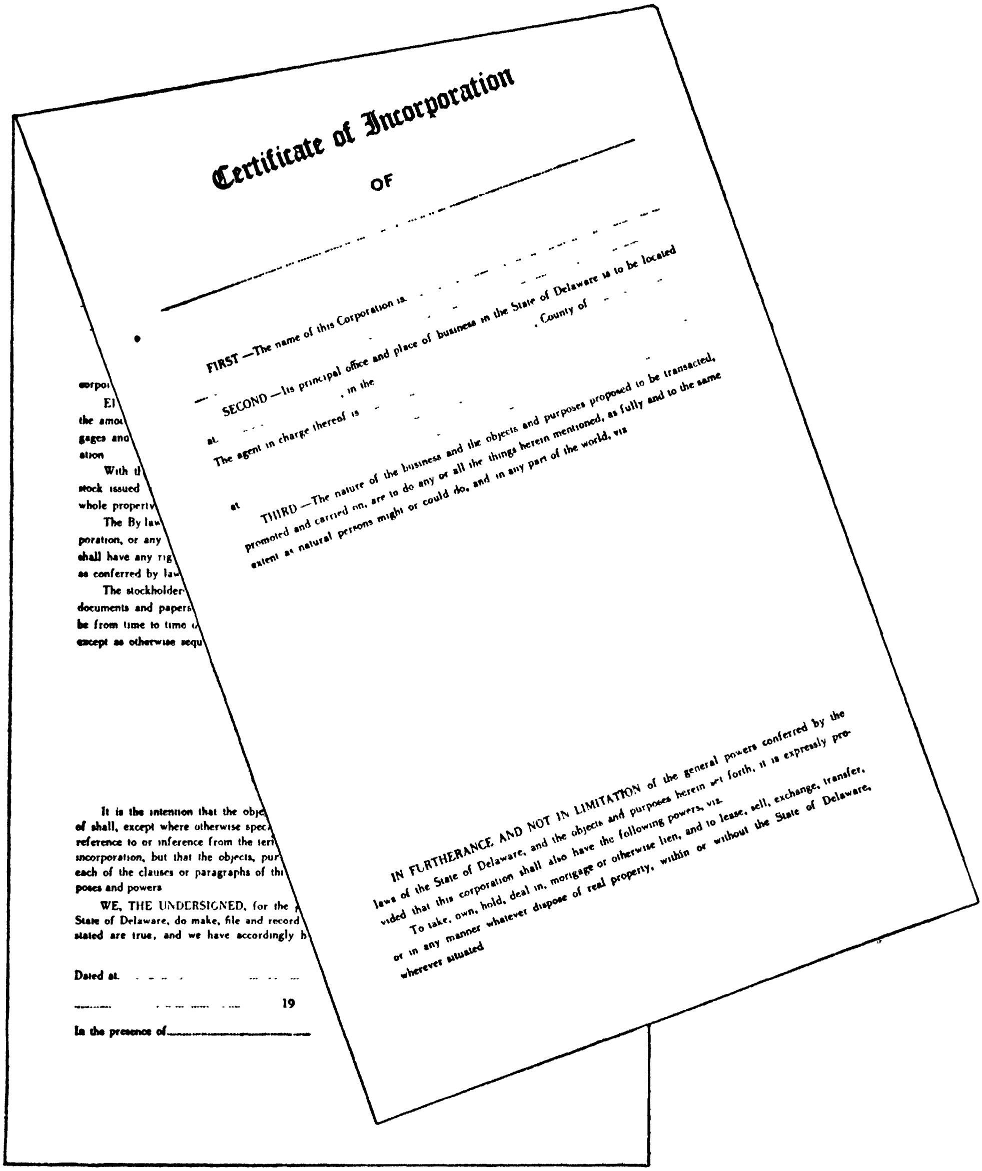
A partnership is purely a matter of contract between the interested parties. Such contracts may be express or implied, written or unwritten. As a matter of practice, partnership agreements are usually written out in a form known as *articles of copartnership.* If it is agreed that the partnership is to be continued beyond a year from the time of the contract, the agreement must be in writing in order to comply with the requirements of the statute of frauds. The statute of frauds consists of a set of laws that provides that certain contracts must be evidenced in writing in order to be enforceable. Beyond this exception, there is no legal regulation concerning how a partnership is formed.

The creation of a corporation is a formal procedure. The interested parties present to the state proposed *articles or a certificate of incorporation* setting forth certain legally prescribed information concerning name, nature, purpose, make-up, etc., of the proposed corporation. If this instrument indicates that the proposed corporation complies with the legal requirements, permission is given to act as a corporation. This procedure is frequently known as *granting a charter.* The articles or certificate of incorporation now become the basis of future operations. More detailed rules may be formulated in bylaws adopted by the stockholders, but these must not contravene the *articles of incorporation* or the laws of the state.

HOW IS A PARTNERSHIP BUSINESS CONDUCTED?

We have already learned that the creation of a partnership is purely a matter of contract among the members composing the firm. Dissolution is equally simple. Partners may discontinue their business whenever they agree to do so. If a partner insists on withdrawing contrary to the wishes of his fellow partners, he may be held liable for breach of contract, but he cannot be compelled to remain in the firm.

Unless otherwise agreed all partners have an equal voice in the conduct of the business. Each partner can bind the firm under any contract that seems necessary for carrying out the normal and routine business of the firm. However, he cannot, without the consent of the other partner or partners, enter into any transaction that will tend to dissolve or radically change the business. For instance, he cannot sell or mortgage the real estate used in operat-



Certificate of Incorporation

OF

FIRST—The name of this Corporation is

SECOND—Its principal office and place of business in the State of Delaware is to be located , in the , County of

at

The agent in charge thereof is

at

THIRD—The nature of the business and the objects and purposes proposed to be transacted, promoted and carried on, are to do any or all the things herein mentioned, as fully and to the same extent as natural persons might or could do, and in any part of the world, viz

IN FURTHERANCE AND NOT IN LIMITATION of the general powers conferred by the laws of the State of Delaware, and the objects and purposes herein set forth, it is expressly provided that this corporation shall also have the following powers, viz.

To take, own, hold, deal in, mortgage or otherwise lien, and to lease, sell, exchange, transfer, or in any manner whatever dispose of real property, within or without the State of Delaware, wherever situated

corpo
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The By law
poration, or any
shall have any rig
as conferred by law
The stockholder
documents and papers
be from time to time
except as otherwise requ

It is the intention that the obje
of shall, except where otherwise spec
reference to or inference from the ter
incorporation, but that the objects, pur
each of the clauses or paragraphs of thi
poses and powers

WE, THE UNDERSIGNED, for the
State of Delaware, do make, file and record
stated are true, and we have accordingly h

Dated at

19

In the presence of

ing the business, put in a new line of goods, sell the whole stock in trade, or move the business to a new location.

HOW IS A CORPORATION CONDUCTED?

A corporation cannot be created without the consent of the state. At least technically it is also true that a corporation may not discontinue without such consent. As a matter of practice the state will generally grant a dissolution whenever requested by the corporation. Conversely the state may not compel a dissolution of a corporation unless the latter has somehow violated its charter or the laws of the state. Unless brought about by lapse of time or some unavoidable and imperative circumstances, a corporation may not dissolve without the consent of *all* the stockholders.

Stockholders, as such, do not usually take part in the routine conduct of the business. They do, however, hold the basic power, and this is exercised through the passing of bylaws and through voting at stockholders' meetings. A stockholder usually has as many votes as he has shares. If he does not attend the meeting, he may authorize someone else to vote in his place. This is called *voting by proxy.*

The stockholders elect a board of directors to conduct the business for them. This board has broad powers, subject to the articles of incorporation and the bylaws. The board may in turn appoint agents and managers to carry on the various phases of the business. The corporation is liable for the acts performed for it by its representatives. The latter are also personally liable if they perform some unlawful act even if it is done for the real or supposed benefit of the corporation.

PARTNERSHIPS AND CORPORATIONS EACH HAVE CERTAIN ADVANTAGES

Why do some people form partnerships, and others, corporations? This is partly governed by the nature or size of the business, partly by the particular existing circumstances, and partly by the emphasis placed upon certain relative advantages of the two types of organizations. From the viewpoint of the owners, a partnership has the following advantages:

1. The partnership is easier to create and easier to dissolve.
2. It is freer to make important changes in the business.
3. Each partner usually has a definite voice in the management.
4. There is no danger of change in owners. In a corporation such changes frequently take place through sale of stock.
5. It is free from certain legal restrictions and from certain taxes.

On the other hand, stockholders in a corporation also have certain definite advantages:

1. Stockholders are relieved of personal liability for debts.
2. They may invest greater or smaller amounts according to their own discretion.
3. It makes diversified investments possible. A person may invest a relatively small amount in each of several corporations.
4. A stockholder is relieved of personal responsibility for the conduct of the business. This may or may not be considered an advantage.
5. A corporation is easy to get into and easy to get out of. You become a member by buying stock. You cease to be a member when you sell your stock.

The preceding listing of relative advantages should be carefully studied and clearly understood. The decision as to whether to invest in a partnership or in a corporation is a matter for each individual to decide on the basis of his inclinations and in the light of all surrounding circumstances.

CORPORATIONS MAY BE CLASSED AS PROFIT OR NONPROFIT

Our discussion of corporations so far has been about those entered into by investors in the hopes of a direct monetary reward. Such corporations are known as *profit* corporations. All such corporations may also be classed as *private* corporations, since they are organized primarily for the purpose of private gain. Included in this group are some organizations known as *quasi public. These are* called *quasi public* because in some respects they resemble public corporations. They are corporations that, although operated for private gain, also serve a public purpose and are carefully regulated by the government. Railroads and public utilities in general are good examples of this type of corporation.

There are other organizations known as *nonprofit* corporations. These corporations exist for the purpose of rendering services to their members or others rather than for the purpose of *monetary* return. These corporations may be either public or private. Examples of public corporations are towns, villages, cities, and school districts. Incorporated religious, charitable, and social organizations are examples of private nonprofit corporations.

Another difference between profit and nonprofit corporations is that the former issue shares of stock as evidence of ownership in the corporation; the latter usually do not. Membership in public corporations is usually derived from citizenship coupled with residence requirements. Membership in private nonprofit corporations is based on specific requirements. For instance, such membership is frequently maintained by the payment of dues and the fulfillment of other specified obligations.

THERE ARE SOME SPECIAL KINDS OF ORGANIZATIONS

Any kind of a business organization may be classified under some one of the three general types of organizations that we have mentioned. However, some of these have peculiarities justifying at least a brief explanation. The organizations that we shall mention are the limited partnership, the joint-stock company, and the business trust.

Limited partnerships. A limited partnership is one in which one or more partners have full personal liability, the same as in a general partnership. In addition to this there are other members, known as *limited partners,* who are relieved by statutes from personal liability for the debts of the firm. In that respect they have the same status as stockholders in a corporation. A limited partnership may be created only in states having special laws permitting such organization. They are restricted by specific rules that may be found by referring to the laws of the particular state.

Joint-stock companies. A joint-stock company is a corporation in form but a partnership in fact. Such companies usually issue shares, elect directors, and pay dividends. However, they are not created by the state and are not legally considered an entity, and their members are personally liable for debts. The joint-stock company has some of the characteristics of both the partnership and the corporation.

Trusts. A business trust is created when several concerns turn over their businesses to a trustee to be operated by him. The owners in return receive trust certificates and are entitled to receive profits in accordance with the agreement laid down in the *deed of trust.* This type of organization is sometimes referred to as a *Massachusetts trust.*

COOPERATIVES—A FORM OF BUSINESS ORGANIZATION

A cooperative retail or wholesale establishment looks much like any other such business. A cooperative is managed much like any other type of business. However, it is organized on an entirely different basis and for a different purpose. A cooperative consists of a group who organize democratically in order to supply their own needs by means of production or distribution (or both) for service and not for profit.

A cooperative business organization, unlike a single proprietorship, partnership, or corporation (1) is owned and operated by those who patronize it, (2) is democratically controlled since each member has only one vote regardless of investment, and (3) distributes profits on the basis of patronage rather than in terms of stock held.

DIFFERENT KINDS OF COOPERATIVES

Cooperatives may be divided into four classifications: (1) buying cooperatives, (2) marketing cooperatives, (3) producer cooperatives, and (4) financial cooperatives. Buying and marketing cooperatives have been rather successful in this country. However, a detailed discussion of them will be taken up in Unit Five.

Producer cooperatives. Few cooperative associations have been organized for purposes of production. It is easier to buy and then resell to the members than it is to produce and sell at a high price. One of the greatest problems faced by the cooperative type of business organization is that of securing able managers. It takes less managerial ability to operate a marketing cooperative—retail or wholesale—than to run a producer cooperative.

The Farm Security Administration since 1934 has given guidance to the formation of producer cooperatives among low-income farmers.

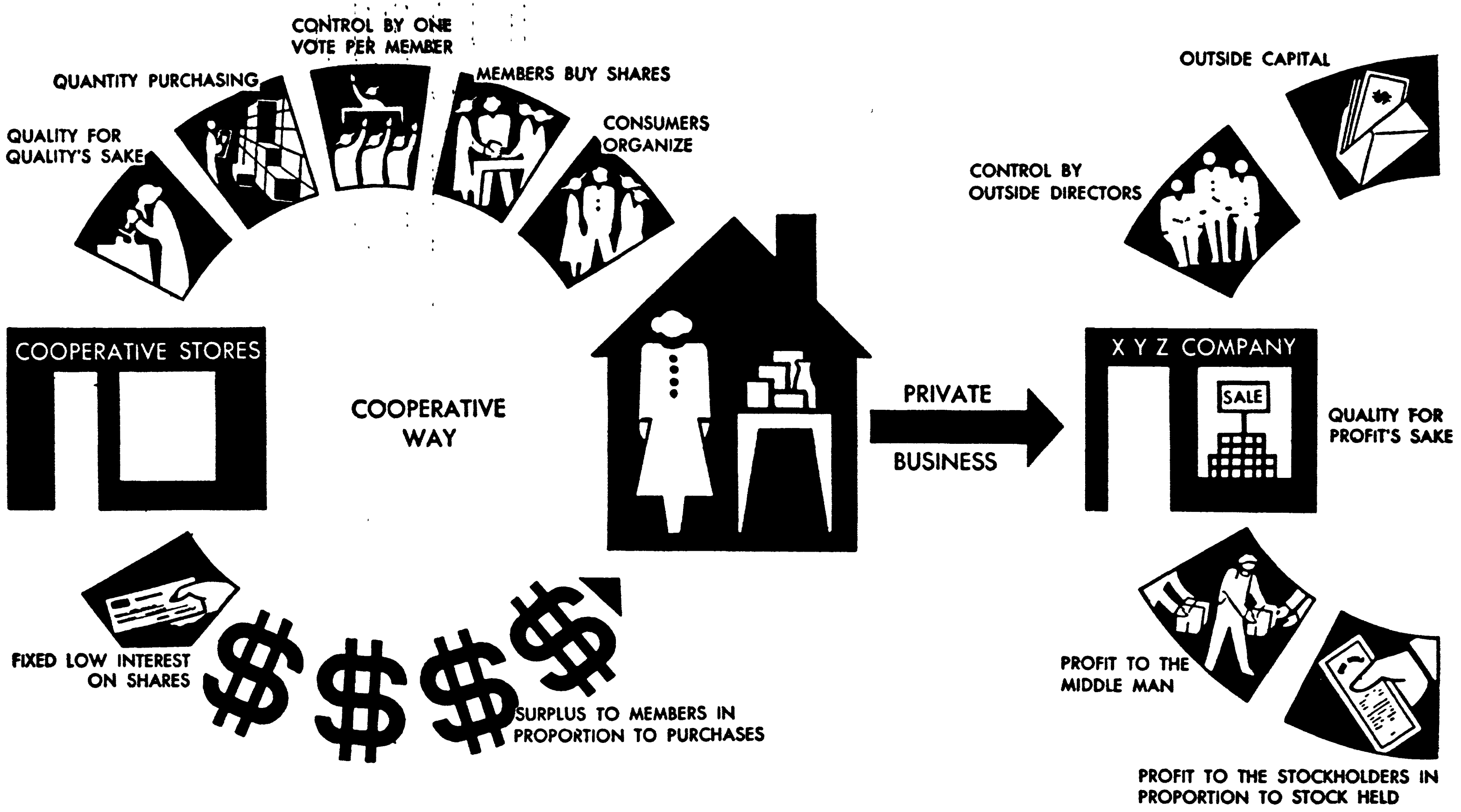
Financial cooperatives. Credit unions are the most popular of the financial cooperatives. A credit union is an organization of a specific group of people with common interests. Their purpose is to build up a fund with their own savings in order to make small loans, usually under $300, to the members. The interest rate of such loans is low as compared with other lending agencies. The credit union, like other types of cooperative organizations, operates on the basis of one vote per member regardless of the number of shares held.

Cooperative insurance is a recent development in the United States. These cooperatives have organized to provide life, automobile, furniture, home, accident, hospital, and medical-care insurance. The Farm Bureau of Ohio promotes one of the most extensive insurance cooperatives in the country. Although the Ohio insurance cooperative started as a farmers' organization, more than half of the members at the present time are from the cities.

DIFFERENCE BETWEEN COOPERATIVES AND CORPORATIONS

Some people confuse cooperatives with corporations. The reasons for this are partly because the names are somewhat similar, but chiefly because they have certain superficial resemblances. Ownership in both a corporation and a cooperative is vested in a group of individuals joined together for some common purpose; both usually have some kind of a governing board. In fact many cooperatives are actually incorporated.

But, although these two types of organizations are alike in a few respects, the dissimilarities are far more basic than the resemblances. A business corporation is created primarily for the purpose of earning profits for its members through the sale of goods or services to the public. A cooperative does not seek business profit in the usual sense of the word but exists rather for the purpose of more effectively providing its members with certain advantages in


CONTROL BY ONE VOTE PER MEMBER
QUANTITY PURCHASING
MEMBERS BUY SHARES
QUALITY FOR QUALITY'S SAKE
CONSUMERS ORGANIZE
COOPERATIVE STORES
COOPERATIVE WAY
FIXED LOW INTEREST ON SHARES
SURPLUS TO MEMBERS IN PROPORTION TO PURCHASES
PRIVATE BUSINESS
OUTSIDE CAPITAL
CONTROL BY OUTSIDE DIRECTORS
X Y Z COMPANY
SALE
QUALITY FOR PROFIT'S SAKE
PROFIT TO THE MIDDLE MAN
PROFIT TO THE STOCKHOLDERS IN PROPORTION TO STOCK HELD

A CONSUMERS' COOPERATIVE AND A PRIVATE BUSINESS. (Reproduced from "Cooperatives in the U.S.—A Balance Sheet," courtesy of the Public Affairs Committee, Inc., New York.)

buying or selling. This general principle gives rise to several practices and procedures observed by a cooperative association:

1. Net earnings are distributed in proportion to patronage, rather than on the basis of ownership. In a buyers' cooperative this has the same effect as reduction in price. In a sellers' cooperative it may amount to a reduction in marketing costs and hence a better net return for the goods sold.
2. Each member has one vote, regardless of the amount of investment. In a corporation one vote is given for each share.
3. Division of profits is on the basis of business done with the association regardless of the amount of ownership. A fixed rate of interest or "dividend" is usually allowed on the investment.
4. Although the corporation puts the emphasis on profit to the stockholders, the cooperative association stresses service to its members.
5. While patronage from outsiders is usually encouraged, the bulk of the business in a cooperative is commonly with its own members.
6. In a cooperative an important objective is the fostering of the "cooperative spirit" and loyalty to the organization.

SUMMARY

The three basic forms of business organization are the single proprietorship, the partnership, and the corporation. Single proprietorships and partnerships have the legal status of individuals and do not normally require the consent of the state for their creation. Corporations are created by authority of the state and are vested by the state with the right to act in the corporate name and to operate in many respects as individuals.

Some special forms are the limited partnership, the joint-stock company, and the business trust. The first two are merely special kinds of partnerships. The function of trustee in connection with a business trust may be taken over by an individual, by a partnership, or by a corporation.

QUESTIONS FOR REVIEW

1. What are some of the main problems to be decided when you start a business?
2. In which of the three main forms of organization would one have most independence? Which would likely permit greatest expansion in size?
3. Which of the three forms is most numerous? Does this mean that it handles the greatest amount of business?
4. For what types of business does the single proprietorship seem best suited?
5. In what kinds of business do partnerships seem particularly suitable?
6. Have partnerships been increasing or decreasing in relative importance?
7. What laws govern the operation of a single proprietorship?
8. Define a partnership. How does this differ from a "venture" conducted jointly by two or more persons?
9. Define a corporation. Can any group of people start a corporation if they so desire?
10. What type of law governs the creation of most corporations?
11. What are the two outstanding differences between a partnership and a corporation?
12. Contrast partnerships and corporations in regard to each of the following points, explaining each as you do so:

    a. As to its legal status as a separate entity
    b. As to its continuity of existence
    c. As to the personal liability of members for debts of the organization
    d. As to the method of creating obligations
    e. As to ownership rights in the profits made
    f. As to control of the organization

13. How does one go about creating a partnership? What does the statute of frauds have to do with organizing a partnership?
14. How does one go about creating a corporation?
15. Are all rules that are to govern a corporation placed in the charter?
16. How is a partnership dissolved?
17. May a partner withdraw from a partnership prior to the time until which he has previously agreed to remain a partner?

18. How much power does one partner, alone, have in deciding upon policies and business activities of the partnership?
19. How is a corporation dissolved? May the state compel the corporation to dissolve at any time the state so desires?
20. How much power does one stockholder, alone, have in deciding upon policies and business activities of the corporation?
21. What is meant by voting by proxy?
22. How many votes does a stockholder in a corporation have?
23. What is the function of the board of directors of a corporation?
24. Name five distinct advantages of a partnership.
25. Name five advantages of a corporation.
26. Give illustrations of nonprofit corporations. Why are they organized?
27. What is meant by a quasi-public corporation?
28. Do nonprofit corporations usually issue shares of stock?
29. How does one usually become a member of a public corporation?
30. Explain what is meant by a limited partnership.
31. What is the general nature of a joint-stock company?
32. Explain the legal principles on which a Massachusetts trust is organized.

TERMS AND PHRASES TO DEFINE OR EXPLAIN

1. Single proprietorship
2. Partnership
3. Corporation
4. Limited partnership
5. Joint-stock company
6. Massachusetts trust
7. Articles of copartnership
8. Articles of incorporation
9. Charter
10. Bylaws
11. Stockholder
12. Board of directors
13. Proxy
14. Quasi public
15. Stock
16. Dividends
17. Legal entity
18. Limited liability

QUESTIONS FOR DISCUSSION

1. Why have the various states set up general incorporating laws that make it fairly easy to organize a corporation?
2. How can you explain the fact that the single proprietorship is the most common form of business organization but that the relative

amount of business transacted by this form of organization is decreasing?

3. In which form of organization do you think the careful selection of your business associates is most important? Why?
4. Why hasn't the partnership form of organization been used more in agriculture?
5. Of what significance is the fact that shares of stock in a corporation are transferable?
6. How can you justify the fact that a partner has unlimited liability for the debts of the organization while a stockholder has limited liability for the debts of the corporation? Do you think this is socially justifiable?
7. Since any partner can bind the partnership in regards to its ordinary business transactions, how can they avoid making conflicting contracts?
8. Do you think it is just that a stockholder should have one vote for each share of stock he owns? How much of the stock would one stockholder probably need to own actually to control the corporation?
9. Under what circumstances do you think it might seem desirable to form a limited partnership?
10. What would you consider an outstanding disadvantage of membership in a joint-stock company?

CASE PROBLEMS

1. R. Jacobson invented and received a patent on a very efficient television receiving set that it seems could be produced at low cost in large quantities. He would like to go into business manufacturing and selling this receiving set. He realizes that through experience he probably could gradually improve it too. He has $10,000 to invest in it, but realizes this is quite inadequate for even a beginning. Advise him as to what form of business organization he should consider.
2. Bill Caldwell is an expert automotive mechanic who enjoys working with automobile engines and doing all kinds of repair work on them. He has an excellent education and some capital to invest. He would like to own and operate a garage but realizes that he is not a businessman and is not interested in business management. Advise him as to what form of business organization he might well consider for his proposed garage.

3. Sally Jones majored in home economics in college and is particularly well versed in the field of clothing. She also studied art and is skilled in the art of designing clothes. Her friend Marjorie Maynard majored in commerce and is particularly interested and well versed in the field of retailing, including retail store management. They have decided they want to operate a dress shop. What basic problems still face them? Advise them as to how they might proceed.
4. Jones and Albright each contributed $2,000 and formed a partnership. In time the partnership fails and is unable to pay debts totaling $6,000. Neither man has any personal wealth except that Jones owns a home valued at about $10,000. Do you think the creditors of the partnership might collect the entire $6,000 from Jones?
5. Johnson and Kelley orally agree to form a partnership to operate a concession at a resort during the summer months. After two weeks Johnson decides to drop out of the partnership and enter another business. He claims that his agreement with Kelley is not binding since it was not in writing. Is he correct in his contention? Does he have a right to withdraw at this time if he so chooses?
6. Carson and Scott are partners in the egg business. One day they agree that they should buy a carload of eggs immediately. Just before lunch Carson places an order with a regular dealer for a carload of eggs. Not knowing of Carson's purchase, Scott places a similar order about one o'clock with another dealer. Are both contracts binding on the partnership? Could Scott be held liable to the partnership for any loss resulting from his purchase of the extra eggs?
7. Simon LeGrew owns half of the capital stock in a corporation with assets of $100,000. Through his control of the votes he elects his personal friends to the board of directors, and they in turn elect him president of the corporation at a salary of $15,000 per year. Tom Cable, who owns a small amount of stock in the corporation, thinks this is unwise and objects to the proceedings. Is there anything Mr. Cable can do about this?
8. Dumont, Casidy, and Henning organize a partnership under a state law permitting Henning to limit his liability to the $5,000 which he invests. Later the partnership fails, owing debts of over $20,000 after all assets had been turned over to creditors. Could creditors still sue Henning for any or all of the $20,000 and win a judgment?

SUGGESTED PROJECTS

1. Consult the state code of your state, or some other reference, and determine whether it provides for limited liability partnership, and if so what the requirements are for organizing such a partnership.
2. Determine the minimum number of persons that your state allows as stockholders in applying for a corporation charter.
3. Investigate the various types of phrases and terminology used in stating the "purposes" in corporation charters. Should this section of the charter be brief or long; general or detailed? Report your findings to the class.
4. Profits belong to the corporation instead of the stockholder until dividends are declared. Examine published balance sheets and report to the class how such profits still held by the corporation are shown on these balance sheets.

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9. Methods of financing

PREVIEW: Many businesses fail because of unwise financing. Whether a proposed business is a popcorn stand or a big steel mill, capital is required in order to operate. There are various ways and means of financing a business. How can money be obtained to finance a business? Should one borrow money?

WE ALL NEED MONEY

From the college freshman seeking the wherewithal to buy a saxophone to the most gigantic corporation launching a business enterprise, the financial question is basically the same: How am I to raise the money? This is *financing.*

Any kind of business concern—individual proprietorship, partnership, or corporation—has three general sources of capital:

1. Original contributions by owners
2. Borrowing from others
3. Accumulation of assets through undistributed profits

Some people, metaphorically speaking, talk about "starting a business on a shoestring." This usually means that they start out on almost nothing or on borrowed money. The more common and conservative procedure is to begin chiefly with an adequate amount of the owners' own funds, with only a minor portion being borrowed. Later this original fund may be supplemented by profits, loans, and further contributions by the owners.

The amount of money required varies considerably with the nature of the business. For instance, in the case of certain service establishments the amount of initial capital is negligible. A capable person with good credit may also operate certain types of small stores with a rather small amount of invested capital. In this case the business is largely financed through credits extended by the wholesalers. On the other hand, banks, most manufacturing concerns, and railroads presuppose the existence of a relatively large amount of owned capital. A capable and enterprising person with only a small amount of money of his own may manage to go into business, either by going into partnership with one or more wealthy persons or by promoting a corporation and selling stock to others. In such cases he would of course be only a part owner of the business.

WHY DO PEOPLE BORROW?

The freshman mentioned in the previous section might wish to borrow so as to enjoy at once the satisfaction of owning a saxophone. Others might want to borrow in order to tide over a period of illness, unemployment, or other temporary misfortune. In other words, individuals frequently borrow in order to gain present enjoyment or to avoid present destitution. Either one of these types of borrowing may be designated as *distress borrowing.*

Distress borrowing is relatively uncommon in business. Of course there are many instances when a businessman needs to resort to borrowing from banks in order to meet pay rolls and other current obligations. This, however, is *refinancing* rather than financing and does not increase his sum total of debts. By incurring a debt payable several months hence he is able to pay a debt which is now due.

Normally a business concern borrows, in the strict sense of the word, only when it is anticipated that the money borrowed will somehow yield a greater return than the interest paid. For instance, it may pay to borrow money from a bank at 6 per cent a year in order to take advantage of a 1 per cent discount offered for paying one's bills 30 days ahead of the due date. Suppose Fred Jones, proprietor of Economy Grocery, owes $500 with a 2 per cent discount if paid in 10 days. However, in 30 days he must pay the full $500. It will cost Jones only $2.50 to borrow $500 from the bank for 30 days at 6 per cent. However, he will save $10 by paying his bill within the 10-day period. Thus his net saving will be approximately $7.50. Actually, he might need to borrow somewhat less than the full $500 and for as short a period as 20 days, thereby increasing his net savings even more.

The Value of Cash Discounts

½% in 10 days, net 30 days	9% a year
1 % in 10 days, net 30 days	18% a year
1½% in 10 days, net 30 days	27% a year
2 % in 10 days, net 30 days	36% a year
2 % in 10 days, net 60 days	14% a year
2 % in 30 days, net 60 days	24% a year
2 % in 30 days, net 120 days	8% a year
3 % in 10 days, net 120 days	10% a year
3 % in 10 days, net 60 days	21% a year
3 % in 30 days, net 60 days	36% a year

It usually pays a corporation to issue 5 per cent bonds if it is fairly certain that the extra money will yield say 7 per cent in the form of increased profits. An individual may find that it pays to borrow money to buy a home because interest, taxes, maintenance, and depreciation will be less than he now pays in rent.

Let us suppose that an individual or a corporation is conducting a business which is yielding an 8 per cent profit on the invested capital. We shall further assume that the profits will increase in direct proportion to the increase in capital. Let us compare the earnings of the owners if they increased their capital from $100,000 to $150,000 by borrowing $50,000 at 5 per cent.

If $50,000 is borrowed:		
Income from $150,000 at 8 per cent	$12,000	
Less interest on $50,000 at 5 per cent	2,500	
Net earnings		$9,500
If continuing with $100,000 owned capital:		
Income from $100,000 at 8 per cent	$ 8,000	
Net profit from borrowing		$1,500

BUSINESS FINANCING SHOULD BE BALANCED

Based on the nature of his business and all other surrounding circumstances, a businessman should be able to work out a well-balanced plan of financing. To what extent should he invest his own funds? To what extent should he borrow? How much of his profits should he retain in the business?

In a stable business enjoying substantial and constant profits a reasonable amount of borrowing may be perfectly sound as well as profitable. The one important thing to remember in connection with borrowing is that, to remain solvent, the interest must be paid regardless of whether profits are earned, and the principal must be paid or satisfactorily refinanced at maturity. It is impossible to lay down any rule in that connection which would be applicable to all circumstances. It is, however, a safe general rule that few concerns should carry debts amounting to more than one-half of the conservative value of their total assets. There are many factors such as type of business, product, and business conditions that must be considered in deciding when and how much to borrow.

Some concerns pride themselves on their ability to finance their expansions out of profits. This is usually a desirable procedure, and it is certainly conservative. However, there is a limit to this method. After all, the ultimate purpose of business is to provide income for its owners. If the distribution of income is unduly and indefinitely withheld, this purpose is to that extent defeated. Furthermore it may not be wise to postpone the profitable expansion of a business until funds accumulate through profits. It may at times be far more profitable to speed up the reaping of prospective profits by making use of one's credit potentialities.

In concluding this portion of our discussion we will point out the basic difference between the claim of an owner and that of a creditor against a certain business: The creditors are in a preferential position, since they have a fixed claim that must be paid before the owners get anything. In some cases the owners do well if they succeed in paying their debts, to say nothing of getting something for themselves. To compensate for this the owners may have the opportunity of reaping huge profits, whereas the creditors never get more than the prearranged amount. Although the owner takes the greater risk he also stands to make a proportionately greater profit.

BORROWINGS MAY BE SHORT TERM OR LONG TERM

Borrowing may be divided into two general types: long-term borrowing and short-term borrowing. Short-term borrowings are entered into for the purpose of providing for certain curent needs. Long-term loans are taken out as a somewhat permanent method of financing the business. Since short-term loans are essentially the same regardless of the nature of the business, these will be considered here. Long-term loans will be discussed in subsequent sections.

Short-term financing consists chiefly of bank loans and the purchase of goods or services on credit. Most business concerns have alternating periods of high and low demand for funds. This situation may well be taken care of by means of bank borrowings. Money may be borrowed when cash reserves are low, and loans repaid when cash is relatively plentiful. Some concerns maintain a rather constant debt to the banks by periodically renewing their notes rather than paying them. This practically results in long-term financing through bank loans. Embarking upon a considerable amount of this type of long-term financing is usually undesirable both from a business and a banking standpoint.

A good example of short-term borrowings for seasonal needs is provided by the practice of some canning factories. Such factories as those canning peas, beans, and corn will be in operation about 3 months in the year. During this time there will be heavy outlays for labor and materials, while the amount of sales may be low. The canning concern may borrow from the bank with the understanding that the debt will be repaid during the fall and winter when the canned goods are sold. Within reasonable amounts, these loans are good from the viewpoint of the bank, since the goods in stock may serve as security for the debts and the payment of the debt within a few months is fairly certain.

A considerable amount of our sales today is made on account. To offset this, manufacturers and dealers frequently buy on account. Buying on credit, of course, releases an equivalent amount of the funds of the business for other purposes and is an important source of short-term financing. To maintain a good credit standing, bank loans and accounts payable should be kept within reasonable bounds. A good general rule is to maintain at least a ratio of 2 to 1 between current assets and current liabilities. In other words the value of the assets should be at least twice the amount of the debt. Current assets are either cash or assets that are likely to be converted into cash soon. The most important current assets are cash, accounts and notes receivable, and inventories. Current liabilities consist of accounts payable and short-term borrowings.

FINANCIAL STRUCTURES SOMETIMES SIMPLE

The simplest possible form of financing would be to have no debts and to sell only for cash. For reasons previously discussed, this procedure is conservative but not always conducive to the highest profits. Few business concerns avoid debts entirely, and not many refrain entirely from extending some credit.

A typical single proprietorship or partnership may finance its business in the following manner:

1. Provide the more permanent capital through contributions by the proprietors, accumulation of profits, and long-term borrowings on notes usually secured by a mortgage.
2. Take care of current needs largely through short-term financing.

CORPORATION FINANCIAL SETUP MORE COMPLEX

Although the end results in financing are the same, corporations have a somewhat more complicated way of going about it than is the case with the single proprietor and the partnership. This difference arises primarily in connection with long-term financing. Corporations derive revenue for their long-time needs chiefly through four sources:

1. The sale of *common stock*
2. The sale of *preferred stock*
3. The sale of *bonds*
4. Accumulation of *surplus*

The proprietorship in a corporation is evidenced by its *capital stock* and *surplus*. The capital stock consists of shares of stock owned by the stockholders. Sometimes a corporation reacquires part of its own stock through gift, purchase, or forfeiture. The company may then hold the stock for reissue at a future time. Such stock is called *treasury stock*. The documents evidencing holdings of stock are called *stock certificates*. Each share represents a part ownership in the net assets of the corporation, and the owner of such stock may increase or decrease his ownership by means of the purchase or sale of shares. The income from his investment is derived in the form of dividends distributed out of profits on the basis of his holdings of shares.

Surplus in a corporation is derived from the retention of earnings in the company. The decision of how much of the earnings to pay out as dividends and how much to retain as surplus is generally left to the board of directors, and this involves an important element in the financial policy of the corporation. Perhaps the most important purpose of a surplus is to offset possible future losses.

STOCK MAY BE COMMON OR PREFERRED

When a corporation offers stock for sale, it may wish to appeal to different kinds of investors. Some people prefer an investment that promises a rather fixed return even if such return is relatively low. Others are willing to take chances in return for hopes of greater profits if everything goes well. The former class is apt to buy preferred stock; the latter, common stock.

Common stockholders are those who have a claim to everything that is left over after all the other claimants are paid. Preferred stockholders are those who are entitled to a certain rate of dividends before the common stockholders get anything. In most cases the fixed rate is also the maximum that the preferred stockholders may receive.

We should not jump to the conclusion that preferred stock is necessarily better than common stock. If the company has a very profitable business, the holder of common stock may get far greater dividends than the holder of preferred stock. Furthermore the common stockholder has the right to vote at stockholders' meetings and thus has a voice in directing the management of the business. This right is commonly denied to preferred stockholders. However, preferred stock does have the decided advantage of providing greater assurance of a fixed and steady income.

THE CORPORATION MAY ISSUE SPECIAL KINDS OF STOCK

We have heard that corporations sometimes issue preferred stock in order to appeal to people who feel that too much risk is involved in connection with the ownership of common stock. However, even the preferred stock is subject to a certain degree of ownership risk. Dividends on any kind of stock are usually dependent upon the existence of a *surplus,* and a surplus is created out of earnings. If the earnings are inadequate, the preferred stockholders will fail to get the stated dividends. There is no guaranty that preferred dividends will be paid. The only thing the corporation agrees to do is to pay the preferred dividends before it begins to pay dividends on the common stock.

Sometimes certain special inducements are added to preferred stock to make it more attractive to investors. The most common of these devices is to make the stock *cumulative.* Cumulative preferred stock provides that, if in certain years a stockholder does not get his specified dividend, the deficit must subsequently be paid to him before the common stockholders can get any dividends. Another plan is to make the stock *participating.* This means that, in addition to the stated rate, some provisions are made to allow the preferred stockholders to share in the excess earnings after certain specified claims by the common stockholders have been met. The participating feature is, of course, important only when earnings are high.

BONDS MAY BE ISSUED

With respect to the nature of the claim, bonds are in an entirely different category than either common or preferred stock. A bond is a formal, long-time note, usually issued in even denominations of, for instance, $100 or $1,000 each; the issuing corporation promises to pay a fixed rate of interest and to pay the principal in full at maturity. From this definition it will be noted that payment of interest is not contingent upon profits. Likewise the bonds must be paid at maturity whether there is anything left for the stockholders or not. Stockholders, whether common or preferred, are owners and bear the risks incidental to ownership. The bondholder is a creditor, not an owner.

WHAT WILL THE CORPORATION DO WITH ITS MONEY?

Let us suppose that a certain corporation has been organized for a given purpose and has succeeded in raising an initial sum of

$1,000,000 through the sale of shares of stock and through issuing bonds. The next question is how to distribute this cash properly in the purchase of the assets that are needed for the successful operation of the business. There should be a certain balance between fixed and current expenditures. For instance, the company, if a manufacturing concern, might tie up so much money in buildings and machinery that there would be nothing left for buying materials, meeting the pay roll, and, in general, taking care of the scores of other obligations that arise before sales are made. On the other hand some companies may maintain excessive reserves of materials and cash but skimp on their investment in buildings and machinery. There is no standard or universal rule regarding the allocation of funds within a business. The only guiding principle is to endeavor to provide the proportion and balance that will provide the highest net profit for the company.

Corporation A started business with 1 million dollars. A considerable portion of this money was raised by issuing bonds, secured by a mortgage on the fixed assets. The company had an excellent building and the best of machinery and equipment. After purchasing these things, the company had only $25,000 left with which to finance current operations. The result was that it sometimes had difficulties in meeting the pay roll and sometimes had to curtail operations because of temporary inability to finance the purchases of materials.

Corporation B was in an entirely different situation. This company issued stock for 1 million dollars and had no debts. It retained $200,000 in cash. It always had plenty of money, but the company might have done better if it either had not sold so much stock to begin with or had invested more in improved or expanded production facilities. Idle money does not earn dividends for its owners.

SUMMARY

There are three general ways of financing a business enterprise:

1. Contributions by owners
2. Borrowing
3. Accumulations

Launching an enterprise by means of contributions by the proprietors and expanding it through the withholding of profits is the most conservative method of financing. The amount of debt that may be contracted as a profitable way of expanding the business depends upon the type of business as well as other factors.

The proprietorship in a corporation is represented by the capital stock and surplus. Capital stock may be either common or preferred. There are many kinds of preferred stock, but the basic feature in connection with all such stock is that a specified rate of dividends must be paid on it before the common stockholders get anything. The common stockholders are entitled to whatever is left over. Dividends cannot legally be paid on any kind of stock unless there is a surplus adequate for the purpose.

Loans may be either short term or long term. Short-term loans consist chiefly of bank loans and short-term credit on purchases. Long-term loans are frequently backed up by mortgages. Such obligations usually take the form of bonds. Bondholders have creditor claims against the corporation. They are entitled to interest regardless of profits and have the preference over stockholders in case of liquidation of the business.

QUESTIONS FOR REVIEW

1. What are the three general sources of capital?
2. The more conservative procedure in starting a business would use which source primarily?
3. What is meant by distress borrowing? Is it common in business? For what purposes may it be used outside the business world?
4. What is meant by refinancing? Does this increase the total debt?
5. Under what general conditions does it pay a businessman to borrow?
6. If profits of a business fluctuate greatly, is it relatively safe or relatively dangerous for that business to borrow extensively?
7. Is it necessary to pay interest on indebtedness when there is no profit being made?
8. Can any general rule be made as to when the size of a debt has passed the safety margin?
9. Would the policy of financing expansions out of profits be considered conservative or not? What two objections can be raised to this as a policy?
10. What is meant by the statement that "creditors are in a preferential position"?

11. What is meant by the statement that the "owner bears the brunt of the risk"? Why, then, is he willing to do this?
12. Distinguish between the purposes of long-term and short-term borrowings.
13. May long-term loans be looked upon as a permanent method of financing a given business?
14. What are the two most common means of short-term financing? Which of these is the more common?
15. What is meant by current assets? by current liabilities? What ratio may well be maintained between the two for safety in borrowing?
16. Failure to borrow may result in loss of potential profits. Hence, what may be considered a typical simple financial structure?
17. What are the four main sources through which corporations derive their long-time finances?
18. What two items evidence the proprietorship interest of a corporation?
19. Explain how a corporation may come to possess treasury stock.
20. What two things, in general, may be done with the earnings of a corporation? Who decides which should be done?
21. Why is it relatively important that most corporations have a surplus?
22. Explain the general difference between preferred and common stock. Why may a corporation wish to have both types of stock?
23. Under what conditions would each of these two types of stock be considered desirable investments?
24. What would be meant by cumulative participating preferred stock?
25. Why might an investor prefer a bond to cumulative participating preferred stock?
26. Does any stockholder ever have a guarantee of dividends?
27. Explain this statement: "Stockholders are owners; bondholders are creditors."
28. Once a corporation has raised its capital, how is it going to decide what portion to spend for current assets and what portion for fixed types of assets? What danger may exist here?

TERMS AND PHRASES TO DEFINE OR EXPLAIN

1. Distress borrowing
2. Creditor
3. Purchase on credit
4. Current assets
5. Common stock
6. Cumulative preferred stock
7. Stock certificate
8. Proprietorship

9. Refinancing
10. Long term
11. Sale on credit
12. Current liabilities
13. Preferred stock
14. Participating preferred stock
15. Dividend
16. Capital stock
17. Profit
18. Short term
19. Assets
20. Current ratio
21. Treasury stock
22. Surplus
23. Bond

QUESTIONS FOR DISCUSSION

1. Compare or contrast the problems and methods of financing a college education with the problems and methods of financing a business as it has been presented in this chapter.
2. To what extent do you think the lack of capital may prevent some people from starting and operating a business, and thus to some extent result an "undemocratic" selection of business proprietors?
3. May one borrow money with only character and personal ability as security for the loan?
4. Under what conditions do you think it would be questionable whether a concern should finance expansions out of profits instead of borrowing?
5. What is the objection to repeatedly and continuously raising capital through short-term bank loans?
6. Why is it that banks in general like to see a current ratio of at least 2 to 1?
7. Do you suppose any business exists that has no debts and sells strictly for cash?
8. What security would a business need to give a bank for funds borrowed for a short time? Would the same answer hold for long-term funds?
9. If you were offered a gift of 100 shares of stock in a certain corporation and could take either common or preferred stock, which would you take?
10. How do you suppose a business with a million dollars in bonds maturing in 10 years might arrange to pay off the debt when it came due?

CASE PROBLEMS

1. Two college graduates, Phyllis Smith and Jean Andrews, decide they would like to operate a tea room as partners. They have abso-

lutely no capital. Do you think they may be able to raise the necessary capital? How?

2. In the preceding case, suppose each girl had been working for a while and that each had saved $500, which she could now invest. How would this influence your answer?
3. The Perambuker Company has been enjoying rapidly expanding business and unusually large profits. The board of directors has decided to build a large addition to the plant. The members of the board are now considering the problem of whether to "pass" dividends for this year and finance the expansion out of profits, or whether to declare a normal dividend and then borrow money for the expansion program. What are some of the points they will consider in making their decision?
4. The Jensen-Smith Corporation was financed entirely from sale of stock to a very limited number of stockholders. Recently it has been making an annual profit of from 10 to 20 per cent continuously and at the same time expanding by "plowing in" nearly all earnings. Prospects for the future look equally good. Do you think it would seem wise for this company to expand more rapidly through the issuance of bonds? Would your answer be the same in regards to the issuance of nonparticipating preferred stock?
5. John Hancock is paying $45 per month rent for a house. He has an opportunity to buy the house for $5,000. He has saved $2,000, which he has invested at 4 per cent interest but which he could use as a down payment. He could borrow the remaining $3,000 at 6 per cent interest. He now is wondering whether it would pay financially to buy the house. What conclusion would you draw from this information?

SUGGESTED PROJECTS

1. Secure and bring to class the published balance sheet of some large corporation. Explain to the class some of the methods of financing used by the corporation as shown on the balance sheet. Be prepared to answer questions that the class may ask.
2. Consult the "Encyclopedia of Social Sciences" or some other appropriate reference and select some information about stock, bonds, or methods of financing that has not been presented in this chapter and explain it to the class. Select only some specific item.
3. Refer to a current issue of *Commerce and Finance* or the *Commercial and Financial Chronicle* or some large metropolitan news-

paper and report to the class any information you can secure from it regarding current stock or bond prices, or dividend or interest rates.

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10. Location

PREVIEW: Many factors are involved in deciding where a business should be located. Today the importance of location is recognized by businessmen. Serious consideration is given to the problem. Scientific data are gathered and analyzed in making decisions with respect to where to locate a business. What are some of the factors that should be considered in locating a business? Do all these factors apply to all types of business?

WHY IS CHICAGO BIG AND SUNSET CORNERS SMALL?

On the part of many people, little thought is given to the reason for the size of particular communities. In fact there are some people who seem to think that we might as well avoid congested areas by spreading our industries rather indiscriminately all over the country. As a method of avoiding congestions, this would be a laudable procedure. There are, however, excellent economic reasons for not doing so. Large cities don't just happen. There is a reason.

Let us consider Chicago, for example. How can this city maintain a population of over three million? The answer is that in most respects it has a location that would be difficult to excel. The Great Lakes on which Chicago is located also touch the shores of states possessing one-third of the resources and population of the nation. Something like 35 railway systems terminate in this city. In addition to all this, the city has excellent airplane, bus, and truck connections. Finally the city is the center of a net of interstate highways and has a fine system of internal transportation.

Not only does Chicago have excellent transportation facilities, but the distances that materials must be carried are in most cases relatively short. A few hundred miles to the north there is an abundance of iron ore. Within short distances in other directions there is an abundance of coal. Scores of other materials, chiefly farm and forest products, are equally accessible.

Finally it must not be overlooked that Chicago presents a wonderful local market. The city itself has a population of over three million and perhaps two million more live within 100 miles. Nearness to market will not of itself make a small town big. However, when combined with advantages for production, it is an important contributing factor.

SUNSET CORNERS NOT SO FAVORABLY LOCATED

Sunset Corners is the typical country village with a population of less than a thousand. It may be a good place in which to live, but it probably never will be the scene of humming mills and bustling traffic. Why? Well, if we may use a colloquialism, it just doesn't have what it takes to make things hum.

Sunset Corners is served by one lone branch railway and has only one paved highway running through it. Except for certain farm products it has no materials within hundreds of miles, and the inadequate transportation system precludes profitable shipment. The same lack of transportation limits the potential marketing area to only a few miles surrounding the town. Since the town devotes its efforts chiefly to supplying immediate local needs, there is no great variety of skilled workers.

Sunset Corners, no doubt, has ambitions. These ambitions, however, are limited by the industrial potentialities of the community.

DISTINCTION BETWEEN CAUSE AND EFFECT SOMETIMES DIFFICULT

In discussing Chicago and Sunset Corners, it may seem that we have, to some extent, confused cause and effect. For instance, the 35 railroads and the huge markets in Chicago did not exist to begin with. Should not these therefore be considered as effect rather than as cause?

The question could be partially answered by either "yes" or "no." In the growth of a city we have the initial causes that produce certain effects. These *effects,* in turn, become the *causes* that bring about other results, and so on in a continuous chain of events.

Let us apply this principle to the story of the growth of Chicago. There are several minor factors that contributed somewhat to giving Chicago its original start, but the most important factor was that Chicago was the nearest and the most convenient point on the Great Lakes for the rapidly expanding Middle West. For this reason, when the western railroads were built they tended to converge on Chicago. Naturally, railroads from the East would also end in Chicago, to connect with the western roads. Thus the city grew, and this very growth was conducive to the attraction of more commerce and more industry, and thus the cycle progressed. Which of these developments were causes or effects, or both, we shall leave to the student to decide for himself.

Now what about Sunset Corners? Just the opposite. It did not have the initial advantages, and hence the cycle of progress could never get started.

STUDY OF LOCATION A BROAD SUBJECT

So far our study of location has been confined to the problem of the growth of cities. Although this is an interesting phase of the subject, it is not of great practical importance to most businessmen. Of greater interest to each individual businessman is the problem of location of particular enterprises, especially his own.

The locational factors affecting various types of business activity are by no means the same. A location that is good for farming may not be a favorable location for a retail store. The locating of a mine is one thing; the decision as to where to start a factory is quite another. After a brief mention of farming, mining, and merchandising, the remainder of this chapter will be devoted to the location of manufacturing industries.

LOCATION PROBLEMS IN FARMING AND MINING

You could conceivably open a factory practically any place in the country. It might be a poor location, but it could be done. This is not true in connection with farming and mining. You cannot farm without suitable land, and you cannot mine without a bed of minerals.

In mining the first consideration is the richness of the deposits. This, however, is only a part of the story. The nearness to markets, transportation, the cost and availability of labor, and the cost of power and equipment are other important considerations. In some parts of the world fairly rich mineral deposits lie idle because of disadvantages in one or more of these seemingly secondary factors.

Like mining, farming is first of all determined by the richness of the available natural resources. Here too the question of markets, transportation, and labor may be important factors. Farming is, however, different from mining in one important respect—it permits of a greater possible variety of products. The same piece of land may be used for either corn or cotton. In the Middle West a farmer usually has the choice of a wide variety such as dairying, hog and cattle feeding, or raising corn, oats, rye, and wheat for the market. In this region diversification is the general rule, and the extent of such diversification is determined partly by custom but mostly by experience as to the relative profitableness of the various ventures.

LOCATION IMPORTANT IN MERCHANDISING

The locational problems relating to merchandising stand somewhat in a class by themselves. Most other enterprises tend to be more or less localized. Merchandising must of necessity be dispersed. Wherever there are people there is at least some opportunity for merchandising. It may be said that the main locational factor in merchandising is that of customer convenience. Everything else being equal, the prospective customer will generally buy wherever it is the most convenient for him. Of course everything else is not always equal. For instance, a poor location may be overcome by charging a lower price or by giving better service. This is made possible by the lower rent paid for the inferior location. The importance of location varies with different kinds of merchandise. People will go out of their way to buy certain kinds of goods; other goods can be sold only where it is convenient for the customer just to drop in and buy.

LOCATION USUALLY IMPORTANT IN MANUFACTURING

It is perhaps in manufacturing that the most careful studies have been made with respect to location. Some of the factors in manufacturing that are influenced by location will be discussed in subsequent sections.

The most important factors in location are as follows:

1. *Transportation*
2. *Availability of materials—largely a question of transportation*
3. *Proximity of markets—partly a question of transportation*
4. *Labor and power*

The other factors that might be mentioned are frequently of no decisive importance and include an almost endless variety of circumstances. We shall, however, mention a few of the more common:

1. *Taxes*
2. *Cost of land and construction projects*
3. *Credit and banking facilities*
4. *Nearness of similar establishments*
5. *Availability of special services*
6. *Attitude of community, including special concessions*

MUCH CENTERS AROUND COST OF TRANSPORTATION

Transportation is the most important factor in industrial locations. The cost of transportation may be low either because of closeness to materials or markets or both, or because the location under consideration has a network of good transportation systems. If the location is near an abundance of varied materials, close to a big market, and possesses good transportation systems, it is almost bound to mark the place of a large city.

It has sometimes been questioned if materials and markets should be put down as factors apart from transportation—the contention being that availability of materials and markets results almost entirely from efficient and adequate transportation. This is partly but not wholly true. Nearness is important because with any given transportation a short haul is usually cheaper than a long haul. As a matter of fact there are some products that *must* be made near the source of material. There are others that could be produced economically only near the point of consumption.

NEAR MARKET OR NEAR MATERIAL—WHICH?

It is impossible to lay down a general rule regarding the relative importance of proximity of markets and proximity of materials. It depends upon the nature of the product. The best general rule is that that plan should be followed which, other things being equal, involves the minimum over-all cost. For example, which is cheaper —to ship Nebraska cattle to Chicago to be packed for eastern markets, or to pack the beef at Omaha and ship the finished product? That there is some doubt on this point is shown by the fact that both Omaha and Chicago handle Nebraska cattle. With some products there is little choice. Highly perishable fruits and vegetables must be processed near the supply. Fresh bakery goods must be made somewhat near the point of consumption. Again some materials are so bulky that it scarcely pays to ship them far. On the other hand it would not be economical to ship, over any great distance, low-priced beverages consisting largely of water.

MATERIALS NOT ALWAYS IN ONE PLACE

So far we have talked as if all the necessary materials were in one place. This of course is not generally true. A particular material may be gathered from several sources, and furthermore the processing may involve several kinds of material.

We frequently find that a small plant may produce economically in a given community, whereas a large establishment would not do so well. One reason for this is that, to the extent that relatively local material is available, it is a profitable operation. If it becomes necessary to reach out for more distant sources, the point of profitable production may be overstepped. Good examples of this are found in the production of cheese and butter.

If, say, two kinds of basic materials go into the making of the product, we follow the plan of minimum *total* cost as explained above. We have two things to consider. It is here a question of bringing the two materials together and then shipping the product to the best markets at the least total cost.

The foregoing is well illustrated by the production and marketing of iron. Ore is found in abundance in northern Minnesota, and coal is plentiful in several sections lying south and east of Chicago. The Chicago area and points east also furnish the principal market for iron and steel. It may be a matter of indifference whether we ship the ore to the coal or the coal to the ore; but here we have one of the materials plus the market in one place. It probably would not pay to ship the coal to Duluth, make the iron there, and then send the finished product back to Chicago, Detroit, and Pittsburgh.

LABOR AND POWER ARE IMPORTANT ITEMS

The importance of labor costs increases with the relative amount of such costs that are included in the production of a given product. Owing to favorable living conditions and other circumstances, wages are higher in some communities than in others. The difference may easily be as much as 25 per cent. Other factors may offset this. If not, industries requiring much labor will tend toward the cheaper labor areas.

Wages do not cover the whole labor question. Frequently the quality of the workers and the availability of the right kind of labor are even more important. A person starting a shoe factory in Sunset Corners would have to import nearly all his labor. A person locating in a shoe-manufacturing center can alternately increase or decrease his working personnel according to need with little difficulty.

Power is usually not so big an item as either labor or materials. However, in nearly all industries it is of at least *some* importance. The cost of power varies greatly in different localities, and it is safe to say that if power constitutes as much as 5 per cent of the total cost, it may become a determining factor. In fact there are a few industries that would meet with prohibitive situations if they attempted to locate at a place away from a plentiful source of cheap power.

THE MINOR FACTORS ALSO COUNT

Taxes, cost of land and building, and the banking and credit facilities, although usually classed as minor items, may at times constitute real factors to be reckoned with. This is especially true of taxes. Federal taxes cannot be escaped, but there have been some instances of industrial migrations because of state and local taxes.

Nearness of competing establishments may or may not be an advantage. If the trade is of a merely local nature, there may be excessive competition for the limited market. When goods are made for a large region or on a national scale, concentration of competing industries may be advantageous. Special services will be more readily available, the right kind of labor will concentrate at that center, and buyers will look to that community for the supplying of their needs.

The attitude of the community is worth considering. Is it friendly, antagonistic, or indifferent? Some communities go to extremes in their effort to attract new industries. However, a community should not give special inducements to a factory for which the locality is not suitable in the first place. In the long run it usually develops that the city has a dead industry on its hands. For instance, some factories may be attracted by offers of free building sites or even free buildings. This initial advantage will not long permit the business to survive in the face of other unfavorable conditions.

SCIENTIFIC EVIDENCE SHOULD BE USED IN LOCATING A PLANT

We have so far considered the question of location in a general way. There remains the question as to how a particular concern may decide just where to locate. For example, Company A is attempting to choose a location for a plant manufacturing steam rollers. The whole country lies before the company. What will be the choice?

The primary thing to remember is that the decision must rest on a combination of several factors, not just one. In some cases the market situation may be favorable, but the cost of production may be higher. Sometimes labor may be cheap, but the materials high. Sometimes the conditions with respect to what we have called the *minor* factors may be such as to throw the balance one way or the other. As a basis for its choice the industry might make specifications for each of the units to be produced and then make out a schedule somewhat as follows:

	Location A	*Location B*	*Location C*
Materials	$80	$76	$75
Labor	76	81	82
Power	3	2	1
Taxes	2	3	2
Depreciation and repairs	4	3	5
Other production costs	5	4	6
Marketing costs	10	7	8
Total	$180	$176	$179

From the preceding it will be seen that location B provides the most economical place of production. This is true in spite of the fact that some of the items are more expensive than in the other locations considered.

SHOULD INDUSTRY DECENTRALIZE?

The last fifty years have marked an increase in the growth of metropolitan areas. This marks a tendency toward centralization. During the recent years of this period there has been a definite trend in favor of decentralization, and some practical efforts have been made in this direction, for example, in the meat-packing industry. The question of where it is profitable to draw the line in this matter must be left to careful study and experimentation.

It is certain that industries will tend to locate wherever the owners will make the greatest net profit. For some time to come, industries will likely continue to centralize. Some products just could not be made except in certain limited areas. Other sections have such a preponderance of advantages that no other section could reasonably compete. Finally, as we have already explained, size tends to beget size. A place that has a large population has a labor supply, it has markets, and it usually has a variety of semifinished materials and essential industrial services.

However, there remains some opportunity for decentralization. This is especially true of industries where a particular location is relatively unimportant. Industries having their chief establishments in a large population center may have production and selling branches throughout the country. Small industries may be established to serve local areas. These are some of the factors that promote decentralization, and no doubt their possibilities have not yet been fully exploited.

The chief sociological objection to centralization of industry is the congestion of population that may result. This has been partly overcome by creating metropolitan areas consisting of a large city with a number of suburbs spread out over a considerable amount of territory. With good transportation facilities this may prove to be a fairly good solution of the problem. By this means the essence of centralization is maintained without working any undue hardships upon the people who live in those areas.

SUMMARY

The study of locations may involve many topics such as the growth of cities and the relative locational advantages in connection with farming, mining, and manufacturing. However, the main questions in this chapter are concerned with manufacturing industries.

The most important factors influencing industrial locations are labor, materials, markets, power, and transportation. Of all these, transportation is the most outstanding determinant.

In addition to the foregoing, there are numerous other factors that may at times be of at least some importance. Among such items may be mentioned taxes, cost of land and building, credit and banking facilities, competitive conditions, availability of special services, and the attitude of the community. In addition to this it should be noted that the mere fact that a place is already a great population and industrial center is in itself an inducement for the establishment of more industries in that place.

Centralization of industries has progressed rapidly during the past fifty years. This trend has brought about some rather significant problems. Recently there has been some concrete evidence of a tendency to decentralize on the part of some industries. The fact still remains that for most enterprises centralization is still profitable. However, some industries may operate in a relatively profitable manner by confining themselves largely to the supplying of local needs. The same purpose may be achieved through the establishment of branches. The creation of suburbs is one method of relieving population congestion in metropolitan areas and yet retaining the advantages of centralization.

QUESTIONS FOR REVIEW

1. What objection might be raised to avoiding congestion by spreading industries over the country?
2. What are the main reasons why Chicago is a large city?
3. Are railroads the cause of large markets and large cities, or do large markets cause railroads?
4. Why is it that most small communities can never become large cities?
5. Explain how size begets size.
6. Which can supply the larger portion of its present-day needs, the small rural community or the large city? What difference of importance exists relative to the type of needs that each could supply itself, however?
7. In what way is location of particular interest to the businessman?
8. Compare the problem of location for farming with the problem of location for mining.
9. Since merchandising is found almost everywhere, is location an important factor in merchandising success?
10. In selecting location for manufacturing purposes, what are the five most important factors to consider?
11. Mention several other factors of lesser importance usually in selecting the location for manufacturing purposes.
12. Would taxes ever be the *deciding* factor in selecting a location?
13. What is probably the one most important factor, as a whole, in selecting industrial locations?
14. How might a manufacturing business go about deciding whether market or material were a more important factor to consider in selecting location?
15. How can we speak of locating near "material" when the necessary material may have to come from many widely separated places?
16. In what ways may labor be an important factor in selecting location?
17. How may the attitude of the community influence selection of location?
18. What is meant by "scientific" selection of location?

19. Why is it that we are not likely to see much decentralization of industry so long as we have a free economy under a profit motive?
20. What are the sociological advantages of decentralization of industry?

QUESTIONS FOR DISCUSSION

1. If a rural community of 2,000 population were to be suddenly cut off from communication and transportation with the rest of the world other than its immediate surrounding territory, how would the living of its inhabitants be affected?
2. If a city of three million population were to be isolated from the rest of the world, how would the living of its inhabitants be affected?
3. Would you use the same criteria in selecting a farm site in Iowa as you would in selecting such a site in New Mexico?
4. In selecting a merchandising location, what are some of the factors that determine whether or not it is convenient to customers?
5. Why is rent high when merchandising space is obtained in the heart of Chicago? Exactly why might a businessman be willing to pay this high rent rather than to locate in a much lower rent district a few blocks distant?
6. What difference might exist in factors controlling the selection of a location for a chain grocery store and in factors to be considered in locating an oriental rug shop?
7. Compare or contrast the locational factors important for a women's hat shop with those important for a retail hardware store.

CASE PROBLEMS

1. John Soonier owns and operates a restaurant. Directly across the street from him is a restaurant of about the same size and type owned and operated by P. W. Cronks. Although there apparently is no appreciable difference in prices, service, and quality of food, the Soonier restaurant enjoys much better business than does its competitor. Might locational factors account for the difference in volume of business?
2. The Birch Food Market, which is located on a side street a few blocks away from the business district of a certain city, advertises that its prices are lower because it is in a low-rent district. The Beach Food Market, which is located in the heart of the business district of the same city, advertises that its prices are lower because

of its tremendous volume of business. Could both businesses be sincere in their advertising statements?

3. The automobile industry draws its material from all parts of the world. Yet we find a considerable concentration of this industry in and around Detroit, Mich. Why is this?
4. Frank Dammon and Bruce Thomas have recently graduated from college and decide they are going to build and operate a chicken hatchery. They expect to start in a rather small way and hope to expand the size of their business rapidly to where it will be doing business throughout central United States. Prepare for them a list of information they will need before deciding upon the location for their project.

SUGGESTED PROJECTS

1. Procure from the chamber of commerce of each of several large cities in different parts of the United States information about the advantages of locating in its city. Analyze the statements and compare the ideas therein with those presented in this chapter.
2. Interview two businessmen in different types of business and inquire as to (*a*) how the present locations came to be chosen for their businesses and (*b*) what advantages or disadvantages they may care to point out exist in regard to these present locations.
3. Consult the *Reader's Guide* in your library and find and read a recent article definitely dealing with the subject of location for business purposes. Report to the class the nature of the article and the magazine in which you found it.

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Unit Four • MAKING THE GOODS

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11. Planning and management

PREVIEW: The purpose of planned management is to induce orderly and reliable functioning throughout the business. No business can run smoothly unless proper principles and policies have been adopted that will assure intelligent cooperation. Provision must be made for a clear understanding of the authority and responsibility of each employee. What are the characteristics of the common forms of administrative organization?

THERE MUST BE SOME KIND OF PLANNING

Regardless of the perfection of proprietorship organization, initial financing, and selection of location, the business faces failure unless there is definite and detailed planning concerning its operation. This is true in varying degrees from the operation of a local newsstand to the conducting of a large manufacturing concern carrying on business of an international scope.

The contribution of management to the success of a business enterprise is just as important as material, machines, and labor.

PRINCIPLES AND POLICIES RELATED BUT NOT IDENTICAL

Some people confuse the words *principle* and *policy*. A principle is the thing we believe in and which may form the basis for our policies. A policy is the framework for establishing particular procedures for carrying the principles into effect. It may be one of the principles of a business that it always believes in fair dealings. In conformity with this ideal, one of its policies may be always to retain a staff of loyal and contented workers. On the basis of this the management will devise rules of procedure for carrying the policy into effect. A properly conducted business usually bases its actions upon a few well-defined principles. On the basis of these principles it may develop any number of policies and detailed rules of procedure. Policies are useful in that they permit routinization and uniformity of operation.

A business cannot successfully embark upon a production and selling program without at least a few definite policies. As the business progresses, policies may need to be modified so as to carry out the principles in order to arrive at the objectives for which the business was created.

MANAGEMENT CARRIES PLANS AND POLICIES INTO PRACTICE

Plans and policies are useful only to the extent that they are carried into successful practice. The burden of doing so rests upon what is known as the *management.* Management is vested in the person or groups of persons who have charge of the operation of the business.

The success of management in a business depends chiefly upon two factors:

1. The personal qualities of the managers themselves
2. The type of managerial organization

It is not sufficient that those who are entrusted with the responsibilities of management are what is generally called *good men;* they must be good for the particular type of work to which they are assigned.

The type of managerial organization is also important. The management plan may vary with the size, nature, and complexity of the business. Frequently the determining factor is the availability of a man who has the capacity and the inclination to carry the load of undivided responsibility. Such a person may be very capable in connection with certain phases of the business but not so capable in others.

TYPE OF MANAGEMENT MAY BE SIMPLE OR COMPLEX

In every business, large or small, certain particular things need to be done. These are known as *functions.* For example, we may speak about the functions of buying, producing, selling, and financing. It is clear that these and many other functions must somehow be taken care of by somebody if the business is to continue to operate.

In a very small business we may not always realize that the various functions exist. Frequently the whole business is owned and managed by one man, and the various functions may appear to blend. Nevertheless they are there. Buying, selling, and producing must continue in all business—large or small.

In a large enterprise the various functions stand out more prominently. Specific responsibilities are assigned to particular persons or groups of persons. A more or less elaborate plan of organization and control is maintained.

THERE ARE VARIOUS FORMS OF MANAGERIAL ORGANIZATION

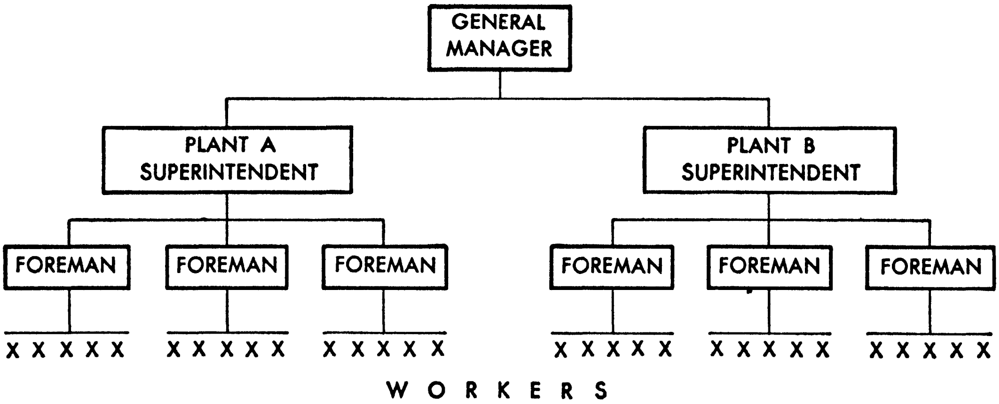
Some kind of predetermined plan of organization set forth in what is known as an *organization chart* is imperative in a large business. If this were not done, there would be no effective way of fixing responsibility, and no one would know precisely what he would be supposed to do. The managerial plans permit a considerable variety, but the following are the three basic types:

1. Line organization, sometimes called the *military* type
2. Functional organization
3. Line-and-staff organization

Each of these types will now be explained. The reader will understand that our discussion must of necessity be brief and very general. For further details the reader should consult at least one of the many books on industrial management.

LINE ORGANIZATION THE MOST CENTRALIZED

The essence of the line organization is that, regardless of how many subordinates there may be, final responsibility is nevertheless carried all the way along the line, through the divisional managers, to the chief executive. As a matter of practice most problems are, of course, settled by subordinates, but the chief executive is always recognized as the ultimate authority. Conversely all major decisions and directions are made at the top and handed down to subordinates next in charge.


GENERAL MANAGER
PLANT A SUPERINTENDENT
PLANT B SUPERINTENDENT
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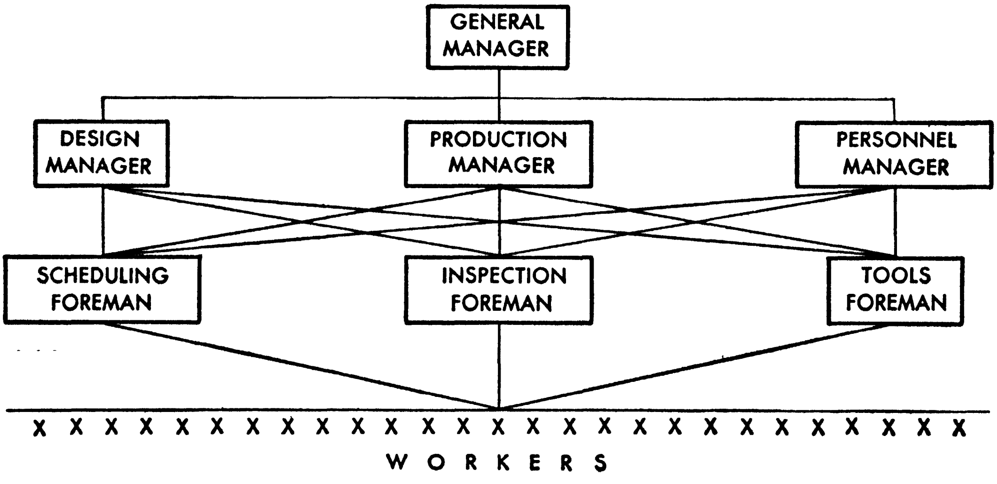
WORKERS

A LINE TYPE OF ORGANIZATION.

The line organization makes for unified action and tends to prevent friction. The chief disadvantage is that it tends to give too little weight to specialized managerial ability.

FUNCTIONAL ORGANIZATION PROMOTES SPECIALIZED MANAGEMENT

Under the plan of functional organization, experts are employed to serve as executives or specialized foremen. The worker is directed not by one particular boss but by several specialized supervisors. In a typical organization the workers may have a time boss, a repair boss, a planning boss, an instruction boss, and a personnel director.

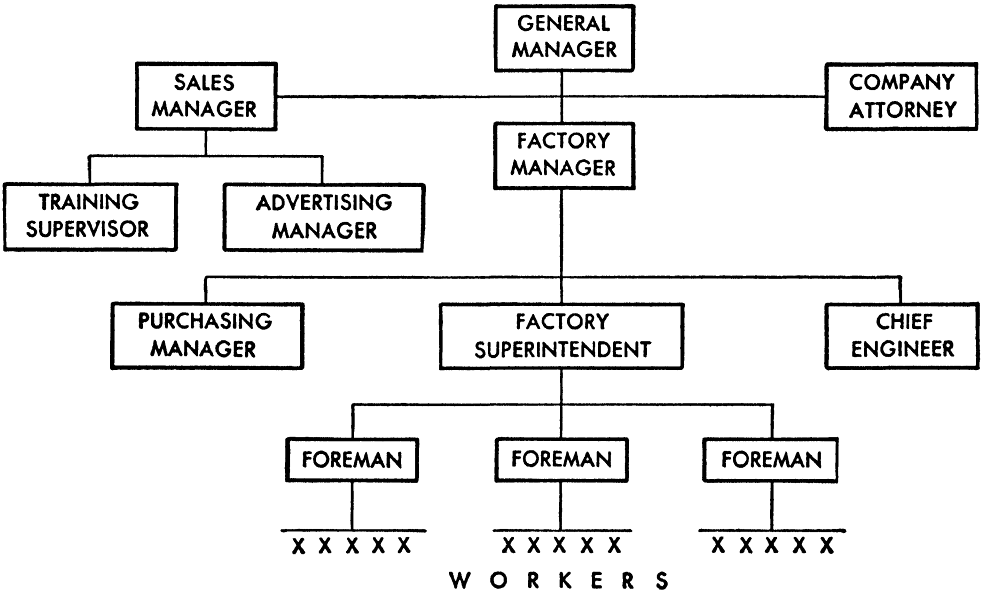

GENERAL MANAGER
DESIGN MANAGER
PRODUCTION MANAGER
PERSONNEL MANAGER
SCHEDULING FOREMAN
INSPECTION FOREMAN
TOOLS FOREMAN
X X X X X X X X X X X X X X X X X X X X X X X X X X X
WORKERS

A FUNCTIONAL TYPE OF ORGANIZATION.

The functional plan of organization provides the advantages of specialization. The possible disadvantages are overlapping of authority and possible confusion and dissatisfaction on the part of the workers. Many of the workers do not like the idea of several bosses.

THE LINE-AND-STAFF ORGANIZATION—A COMPROMISE

The line-and-staff organization provides full administrative control but supplements it by providing the services of experts whose functions are *advisory* rather than administrative. Accountants, legal advisers, and personnel directors are placed on the staff to assist the administration in the conduct of its affairs. In contrast with the practice in the functional type of organization, these experts do not have any directive or executive duties to perform. The essence of the line organization is thus maintained.


GENERAL MANAGER
SALES MANAGER
COMPANY ATTORNEY
FACTORY MANAGER
TRAINING SUPERVISOR
ADVERTISING MANAGER
PURCHASING MANAGER
FACTORY SUPERINTENDENT
CHIEF ENGINEER
FOREMAN
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X X X X X
X X X X X
X X X X X
WORKERS

A LINE-AND-STAFF TYPE OF ORGANIZATION.

The line-and-staff organization sometimes proves itself to be a happy compromise between the line organization and the functional organization. Unity of management is maintained, and yet the business enjoys the benefit of systematic expert advice.

WHAT IS MEANT BY MANAGEMENT CONTROL?

The word *control* in connection with business management refers to any efforts directed toward determining the condition of the business and to systematic methods of applying remedial action. Is the business as a whole operating successfully? Is each person successfully performing his functions? What are some of the loopholes and pitfalls to be guarded against? These are some of the questions that may be answered by means of an efficient system of control.

Even in a small business, personal observation is largely ineffectual and wholly inadequate. In order to make the proper information available for effective managerial control, two things must be done:

1. Pertinent data must be compiled by means of adequate systems of bookkeeping and filing.
2. This information must be conveyed to the management in the form of accounting statements and statistical reports.

WHAT ARE THE REQUIREMENTS OF A GOOD CONTROL SYSTEM?

It is not sufficient that a system of record keeping should present a considerable amount of business information; it should provide the pertinent information essential to insight into the operation of the business. A constant, complete, and detailed record must be kept of the assets, liabilities, and proprietorship interests in the business. It is also important to report on the operations of the business by currently compiling complete information on the sales and the various costs and expenses. All expenses should be properly approved by a written authorization signed by the appropriate official. For example, in a large business no money is paid out without previous proper authorization in the form of a voucher for payment. Other examples of vouchers are those made out for recording depreciation, special credits to customers, and for writing off bad debts.

The executives and others engaged in the management of the business cannot be expected to go to the books and records and dig out the required information for themselves. Persons engaged for that purpose must present the information to them in compact and understandable form. The basic statements to be presented are the balance sheet and the statement of profit and loss. The balance sheet sets forth the condition of the business by showing the resources available for continued operations, the extent of the different kinds of debts, and the amount and nature of the proprietorship. The statement of profit and loss tells the story of the results of operations over a given period of time. This shows the amount derived from sales and other sources of income. From this will be deducted the cost of goods sold and the amount of the various expenses. The final figure will then show the net profit of the business.

The foregoing is further explained and clarified by means of numerous *supplementary* statements and schedules. In a manufacturing concern the most important of these is the statement of the cost of goods manufactured. Examples of other supplementary statements are those showing production costs of particular jobs, detailed listings of certain assets, itemized reports on sales, and statements showing changes in capital. These supplementary reports may be as numerous and as detailed as circumstances justify. In all cases they must be in perfect accord with the balance sheet or the statement of profit and loss as the case may be. The balance sheet and the statement of profit and loss represent the condensed and final reports. The supplementary statements supply the details.

THE MANUFACTURER NEEDS TO KNOW COSTS

In a manufacturing concern an important part of the record-keeping system is what is known as *cost accounting*. Cost accounting need not be confined to manufacturing, but it is here that it has its widest and most common application. In its broadest sense, cost accounting refers to any effort at determining the *unit* cost of any particular process, service, or commodity. In a more limited sense and as applied to manufacturing or other types of production, it refers to the determination of the cost of producing particular units of goods.

Cost accounting involves first of all the keeping of a careful record of all the materials applied to the production of a certain number of units. Next it is essential to have a correct accounting of the cost of the labor applied directly to the job. This is called *direct labor*. Finally allocation is made of the estimated portion of

Relation of Cost Factors to Number of Units Produced

Supply					*Demand*			
No. of units	*Fixed cost (rent, property taxes, interest, heat)*	*Variable Cost (labor, raw materials)*	*Total cost*	*Cost per unit*	*No. of units*	*Selling price*	*Profit margin*	*Gross profit*
100	$1,000	$1,000	$2,000	$20.00	100	$22.50	$2.50	$ 250.00
200	1,000	2,000	3,000	15.00	200	20.00	5.00	1,000.00
300	1,000	3,000	4,000	13.33	300	18.33	5.00	1,500.00
400	1,000	4,000	5,000	12.50	400	17.00	4.50	1,800.00
500	1,000	5,000	6,000	12.00	500	16.00	4.00	2,000.00
600	1,000	6,000	7,000	11.66	600	15.00	3.33	2,000.00
700	1,000	7,000	8,000	11.43	700	14.00	2.57	1,799.00
800	1,000	8,000	9,000	11.37	800	13.00	1.63	1,300.00
900	1,000	9.000	10,000	11.11	900	12.00	0.89	801.00

the total manufacturing expenses that were applied to the particular job. This is usually called *overhead.*

The accounting for the material and labor is purely a matter of recording correctly the amount of these items actually used on the specific job. This can therefore be arrived at with a considerable degree of accuracy. Allocation of overhead to a particular job is less accurate. It is not easy to know exactly how much of the general outlay for taxes, repairs, depreciation, supervision, etc., should be charged to a particular job. The amount to be charged to a certain job is at best only an estimate.

The usual method employed in arriving at the total cost of a certain number of units is to record the actual amount expended for materials and labor and then add the overhead on the basis of so much per direct labor hour or as a percentage of direct labor cost. If the latter plan is followed, the whole plan works out as follows:

Commodity A

(1,000 units)

Materials	$540.00	
Direct labor	400.00	
Overhead (75 per cent of direct labor)	300.00	
Total cost		$1,240.00

Cost per unit $1,240.00 ÷ 1,000 = $1.24

In most situations materials and labor vary quite closely with the number of units produced. This is especially true of materials. Overhead per unit may fluctuate greatly with changing volume of production. Since many of these costs are constant regardless of the amount of production, the per unit cost of overhead tends to go down when the volume of production is high.

COST ACCOUNTING AN IMPORTANT CONTROL DEVICE

It would be difficult for any fair-sized manufacturing plant to operate without some kind of cost records. The following are some of the important control purposes served by these records:

1. They show the relative profitableness of the various commodities produced.
2. They are a guide in fixing prices at a figure that will cover cost of production plus a fair profit.
3. They reveal which products might better be eliminated from the production schedule and which kinds of production should be expanded.
4. They indicate the relative cost of various items from period to period.
5. They furnish detailed information about the allocation of various costs and expenses applied to the profit and are thus a check on departmental efficiency.
6. They show which semifinished products should be produced by the plant itself and which might more profitably be bought from others.

The foregoing will indicate the importance of the establishment and maintenance of good costs systems. In fact it may be said that cost accounting is the core of any form of industrial control.

SUMMARY

The successful operation of a business is largely dependent upon the efficient functioning of principles, policies, planning, management, and controls. All these are related and have as their ultimate objective the smooth and profitable functioning of the business. Principles include the underlying ideas upon which the business is built. These principles form the starting point for plans and policies, and these are carried into practice through management. Control includes all devices that serve as guides to the successful management of the business.

There are three principal types of managerial organization:

1. Line organization
2. Functional organization
3. Line-and-staff organization

The line organization is sometimes called the *military* type because it provides for an unbroken flow of responsibility and authority from the chief executive down. It provides for a high degree of unity and centralization. The functional plan, to a greater or less degree, breaks up some of this authority among certain functional foremen. The line-and-staff organization is a compromise between the two others. The essence of the line organization is maintained, but experts are employed on this staff in an advisory capacity.

Proper principles, policies, plans, and internal organization are prime prerequisites to the successful operation of the business. Cost accounting is an important tool in any form of industrial control.

QUESTIONS FOR REVIEW

1. Can a business be operated successfully without planning?
2. Explain the difference between a principle and a policy. What relation exists between the two?
3. What relation does management have to policies?
4. Successful management is particularly dependent upon what two factors?
5. In selecting managers, is it sufficient merely to select "good men"?
6. What are some of the functions common to most businesses?
7. May the owner himself perform the various management functions?
8. What is meant by an organization chart?
9. What are the three main types of managerial organization? Differentiate among them and point out the main strength of each.
10. With what is managerial *control* concerned?
11. In a business where personal observation becomes ineffectual as a means of control, what is then necessary?
12. Explain the requirements of a good system of control through records.
13. What portion of the records is summarized by means of the balance sheet? What then remains to be summarized by means of the profit-and-loss statement?
14. What is meant by a schedule? What is perhaps the most important schedule used in a manufacturing business?
15. In general what is meant by cost accounting? Explain the three main types of cost shown by such a system.
16. What might overhead include? On what basis might overhead be allocated to the individual unit produced?

17. Mention some of the more important *control* purposes served by a good cost accounting system.

TERMS AND PHRASES TO DEFINE OR EXPLAIN

1. Principles
2. Unit cost
3. Policies
4. Materials
5. Schedules
6. Line and staff
7. Direct labor
8. Management
9. Balance sheet
10. Line organization
11. Organization chart
12. Managerial *control*
13. Business *functions*
14. Staff organization
15. Profit-and-loss statement

QUESTIONS FOR DISCUSSION

1. Would you say that "planning" for business operation is in any way comparable to planning for a college course?
2. Do you feel that a business is likely to have a larger number of policies or of principles? Name a number of illustrative policies that various businesses might have.
3. Which do you think is more important to successful management, the personal qualities of the managers themselves or the type of managerial organization? Might your answer vary with the type of business concern?
4. What are some of the *functions* that the management of a city bus system might have to perform?
5. Discuss in some detail the relative advantages and disadvantages of each of the three main forms of managerial organization.
6. What are some of the vouchers and business papers that should be carefully and systematically recorded and filed?
7. Can you suggest some schedules that might be used to support the balance sheet of a large corporation?
8. Under a given cost accounting system, will the unit cost of a manufacturer remain the same from month to month? If he is engaged in the manufacture of different products, is it possible that some unit costs might increase while others decreased?
9. As the number of units being produced by a given factory is increased, will the three main factors of cost likely all increase at the same rate? What effect will this likely have on the unit cost of production?

10. If you were the general manager of a factory, in what ways might you base your future plans of operation on facts disclosed by your cost accounting system?

CASE PROBLEMS

1. Howard Barnes is general manager of a corporation using the line form of managerial organization. He has been with the company many years and knows his employees well. The employees are satisfied, and the company has been making good profits. However, there is no doubt that final decisions are made by Mr. Barnes. A newcomer to the city buys stock and is elected to the board of directors. He now wishes the board to adopt the principle of employee representation in managerial problems, and to allow employees to have the deciding vote when they so desire. He argues that this is more democratic. Although you may not be able to decide this case definitely, what do you think about it?
2. The James Blue Department Store is in its first year of operation. Mr. Blue owns the store but hires a number of experts to run it, using a functional plan of managerial control. The buyer for one department objects to Mr. Blue because he states that the sales manager for the store has ordered him to stock a certain type of merchandise while the safety manager has ordered him not to do so owing to possible fire hazard. Can you suggest a solution to this for Mr. Blue?
3. Jim Harms, a factory worker under a functional plan of management, is very dissatisfied. The inspection boss repeatedly refuses to accept work he has done, claiming it is unsatisfactory. Jim says this is due to the poor condition of his tools. But the tool repair boss states that the tools are all right, and that the fault lies in the personnel director, who, he claims, has not given Jim the proper training. The personnel director claims that Jim had the same training given other workers who are producing satisfactorily on other machines of the same type. What seems to you to be the trouble here?
4. The Economizer Advertising Company manufactures and sells several different types of advertising novelties. This company is only five years old, but its business has expanded tremendously. It is making a good profit. One member of the board of directors questions the advisability of continuing with one of the novelties; he

doubts if any profit is being made on it. The manager, Mr. Chomman, states that he cannot say positively but points to the excellent profits of the entire business to justify continuation of his present policies and points out that they have manufactured this item for five years now. What type of information does Mr. Cromman apparently lack that it seems he should have? How would you suggest he go about getting it?

5. The Greenwald Grocery Store prepares a profit-and-loss statement only at the end of the year. The head bookkeeper has repeatedly suggested that they do so monthly instead but has been told not to for the extra work entailed would cost too much. If you were the general manager of the store, do you see any possible use you might make of monthly statements that would justify their additional expense?

SUGGESTED PROJECTS

1. Draw up a simple organization chart for a three-department retail clothing store using a line type of managerial organization. The three departments are men's clothing, women's clothing, and children's clothing. Each department has its own manager, buyer, and sales manager, and there is one general manager and one personnel director for the entire store.
2. Draw up a list of personal qualities that you would look for if you were selecting a manager to operate a retail grocery store for you.
3. Consult *Accounting Review* or some other magazine suggested by your instructor and bring to class a list of articles appearing in recent issues that apparently deal with methods of giving the management more accurate and better reports or interpretations of the facts shown by the records. (Do not worry about your understanding of any technicalities; merely search for articles dealing with this general area of giving information to the management.)
4. Consult recent issues of the magazine *Character and Personality* or some similar magazine suggested by your instructor and be prepared to report to the class the nature of any articles you find that you feel would contain information valuable to business managers.

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12. Economical production

PREVIEW: Determining production costs is essential to the success of any manufacturing concern. Individual cost items as well as the total cost must be carefully considered. At times it may be advisable to increase considerably one item of cost in order to decrease others. What are some of the items that constitute production costs? How can these costs be controlled?

VOLUME AND PROFIT MARGIN BOTH IMPORTANT

Any business concern could sell large quantities of goods if it did not pay any attention to the question of making at least a small margin of net profit on items sold. On the other hand it would be an easy matter to raise prices to almost any desired level were it not for the fact that sales usually go down when prices go up above those of competitors. In fact there are situations when even a slight rise above the competitive level will stop sales entirely. To be successful a business must have an adequate volume of sales at prices that will more than cover the various costs of production and sale.

The importance of this principle is frequently not fully realized. To illustrate the point let us look at the results that might be obtained from various policies with respect to the net profit per unit. In each case we shall assume a certain increase in the volume of sales as a result of the decrease in the sales price because of the reduction in the per unit net profit.

It will be noted from the following that the most favorable price is one that will yield a net profit of $6 a unit. If this price is reduced

Cost price	*Selling price*	*Net profit per unit*	*Units sold*	*Total net profit*
$20	$30	$10	1,000	$10,000
20	28	8	1,300	10,400
20	26	6	1,800	10,800
20	24	4	2,500	10,000
20	22	2	4,500	9,000
20	20	0	10,000	0.00

to yield no unit profit, the sales might greatly increase, but there would be no profit.

It is not our purpose in this chapter to discuss the question of selling except in an incidental manner. However, sales cannot properly be divorced from the question of production. Successful production and successful selling go hand in hand. From a strictly profit standpoint a manufacturer has two closely related problems:

1. To produce a particular quantity of certain goods at the lowest possible cost.
2. To sell these goods at a price that, under the existing circumstances, will produce the greatest amount of total net profit over a given period of time.

Volume of production and sales and the margin of profit each mean but little when standing alone. Taken together they represent success or failure.

THERE ARE MANY ITEMS OF COST

Keeping down costs consists of carefully watching a considerable number of items. This problem shall be approached by introducing a rather condensed profit-and-loss statement such as might be presented by a relatively small manufacturing concern.

The following statement will now be used as a basis for a discussion of both the situation as a whole and of the various items involved.

SALES INFLUENCED BY MANY FACTORS

Profitable sales depend upon ability to produce so economically that competition can be met upon a profitable price basis. However, production in itself does not make profits.

Statement of Profit and Loss of the A B C Corporation

January 1 to December 31, 1946

Sales			$1,000,000
Cost of Sales:			
Finished goods on hand, Jan. 1		$40,000	
Cost of goods manufactured:			
Materials	$400,000		
Direct labor	200,000		
Indirect labor	10,000		
Supplies	10,000		
Repairs	10,000		
Depreciation	35,000		
Power	15,000		
Taxes	10,000		
Other expenses	30,000	720,000	
Cost of goods available for sale		760,000	
Cost of finished goods on hand, Dec. 31		30,000	
Cost of goods sold			730,000
Gross profit			270,000
Selling and Administrative expenses			210,000
Net operating profit			$ 60,000

Income from sales may be looked upon as being the reservoir from which all costs and expenses must be paid. When costs and expenses are all paid, it is hoped there will be something left over. This residue is profit.

Profitable sales tie up somewhat with the question of location as discussed in Chapter 10. Nearness to markets in terms of miles or transportation facilities may offset a relative disadvantage in production costs. Everything else being equal, satisfactory sales may result from good sales efforts and efficient selling policies and procedures. A fuller discussion of this will be presented in Chapter 13.

HERE IS THE OVER-ALL COST PICTURE

In addition to the problem of sales there exists the question of *total* cost. It is of course true that total cost is made up of the various component parts. However, management must guard against judging the efficiency of an enterprise on the basis of the specific costs. For example, a concern may have high labor costs and still be extremely successful because of economies in other items. It is the total cost that counts.

The interplay of the various items constituting total cost may be largely directed by the plans and procedures of the business involved. A location may have been selected where materials are cheap and labor high, or vice versa. One location may be favorable with respect to total production costs, but not so favorable with respect to markets. All these locational factors must be considered, both individually and as a whole. Proper supervision, elimination of waste, labor efficiency, and control of materials are other important factors in the total cost picture.

Frequently, extra expenditures for one item may be more than offset by saving in some other item. The best example of this is the saving of wage costs by means of greater expenditures for building and machinery. Such a procedure on the other hand would increase the costs for depreciation, repairs, power, and taxes. Sometimes it may be profitable to spend more on labor in order to decrease other expenses. In some enterprises the opposite situation may be true.

Company X contemplates buying a set of new machinery to cost $1,000,000. These machines will save the outlay for 100 employees getting total wages amounting to $240,000 a year. It is estimated that the machines will last 10 years, and the outlay for repairs, taxes, insurance, etc., will be $50,000 a year. This works out as follows:

Saving on labor cost		$240,000
Annual cost of machinery:		
Depreciation ($1,000,000 ÷ 10)	$100,000	
Maintenance charges	50,000	150,000
Saving per year		$ 90,000

It appears that it would pay to buy the machines, since $90,000 yields a return of 9 per cent on the original investment. The chief factor of uncertainty is that the machines might be idle part of the time, while the depreciation and maintenance charges would largely go on regardless of the extent of use. Interest on the investment and the possibility of idle time should always be considered when the purchase of expensive machinery is contemplated. A liberal margin of safety should be allowed for these adverse contingencies.

THE AMOUNT OF PROFIT NOT WHOLE STORY

The statement of profit and loss of the A B C Corporation showed a net profit of $60,000. This is 6 per cent on the total sales. Does this represent a successful business? In order to know whether or not this is a satisfactory return it is necessary to know the capital investment. If the balance sheet shows a proprietorship of $500,000 it means that there is a 12 per cent return on the investment. Percentage return on what the proprietors have invested is the final criterion in determining the profitableness of a business.

The foregoing does not mean that the margin of net profit on sales is immaterial. True enough, if a business with a capital investment of $100,000 sells $1,000,000 worth of goods at a $10,000 profit, it makes 10 per cent on the investment. However, the net profit on sales is only 1 per cent. This comes painfully close to no profit margin at all. In most cases such a business would be in a precarious position, since a 2 per cent increase in costs and expenses (sales remaining the same) would convert the profit into a substantial loss. The same would be true if cost and expenses remained constant but prices went down as much as 2 per cent. Nevertheless it is true that there are some businesses that operate successfully on an average of 1 per cent net profit on sales.

NOW WE SHALL CONSIDER THE DETAILS

To supplement the general discussion the detailed items making up the total costs will be analyzed. In this connection consideration of selling and administrative expenses will be omitted. Attention will be given to matters pertaining to the cost of manufacturing.

A few of these items will at this time be disposed of with a brief mention. Supplies will be considered as included in our subsequent discussion of materials. Chapter 13 will deal entirely with labor, and this will include both direct and indirect labor.

Taxes are pretty much beyond the proprietors' control. The only way legally to avoid taxes is to have but little to tax. This method is seldom either feasible or desirable. Few persons would refrain from expanding or improving their business merely to escape taxes. Even escaping income tax by eliminating the income would seem like a rather drastic procedure. The whole subject of taxation will be discussed in a later chapter.

"Other expenses" include a number of items that are usually presented in greater detail in most statements of profit and loss. Under this heading would be included such items as insurance, office supplies, supervisors' salaries, and several other items that, for the lack of a better title, are classed as *sundries.* The foregoing items seldom loom large in the total expenses and are generally not subject to any considerable economies. However, when severe competition forces down the margin of profit they may be decisive factors.

REPAIRS AND DEPRECIATION CHARGES NOT THE SAME

Many people somewhat confuse the terms *repairs* and *depreciation.* Both refer to costs in connection with buildings, machinery, and equipment. Repairs refer to actual periodic outlays for upkeep and for keeping the assets in good running order. The charging of depreciation is a bookkeeping device for allocating the proper portion of the original cost to the various periods of the useful life of the asset.

Even under the best of circumstances, machinery may get out of order, and labor and material must be expended to bring it back to its normal usefulness. Buildings may require repainting, reroofing, and scores of other forms of periodic attention. All such items are classed as *repairs.* It will be noted that repairs are anything needed to *maintain* the asset for a normal period of usefulness.

Depreciation charges are something quite different. It is a matter of universal experience that, regardless of how well maintained an asset may be, there is a limit to the length of its useful life. It will eventually be discarded. Let us suppose that we buy a machine for $12,000. At the end of 10 years we expect to dispose of the machine for $2,000. It is clear that during the 10 years we have used up $10,000 worth of machinery. Now what should be our procedure? Should we charge the whole $10,000 loss to the year in which the machine is discarded or should we allocate a proper proportion to each year during which the machine is used? Clearly the latter method is preferable. This is what we mean by depreciation charges.

Some people are careless in the manner in which they handle depreciation charges; since such charges do not involve periodic outlays of money, they feel that they may dispose of this charge in any manner that fits their convenience. Depreciation is as truly an expense as labor and material. There are various ways of allocating the depreciation, but it should be done in some logical, systematic, and consistent manner.

DEPRECIATION AND REPAIRS ARE IMPORTANT

In a manufacturing business using a considerable amount of expensive machinery, repairs and depreciation constitute highly important items. Much can be done to reduce the cost of these two expenses. It all begins when we are about to purchase the assets under consideration. We must then consider efficiency, suitableness, durability, and price. When the asset is installed, we must decide upon our policy of upkeep and repairs. Should we repair the asset only enough to keep the asset operating efficiently for a relatively short time and then replace it, or should we spend a much larger amount in hopes of prolonging the life of the asset? Finally, when is the best time to trade in the asset? Should we keep it as long as we can make it run, or should we trade quite frequently in order to save repair bills and also always have the use of a relatively new asset?

These are only a few of the questions to consider in connection with one's depreciable assets, but they will indicate the general problems involved. The main idea is that repairs and depreciation are, to some extent, offsetting expenses. The more we spend on one, the less we need to spend on the other. It is a problem for management to evolve a plan that will ensure a minimum cost for the two items combined.

POWER COSTS VARY

Under the heading of *power* we also include heat and light. Many industries use very little power except in the form of heat and light. Most industries use a considerable amount of power, and in a few power may be the predominating expense.

The advantage of using an ample amount of power wherever it can be done is so decisive that it seldom pays to reduce its judicious use. However, there is nothing lost by watching out for pure waste. We are not engineers, but even a layman can understand that much power can be saved by proper selection, maintenance, and use of the equipment and machinery. Here again we must strike a balance between two factors: The extra cost, if any, of devices to save power and the value of the power saved.

Frequently a manufacturer is confronted with the choice between producing his own power or buying it from an outside source. The relative merits of these two plans are of course something on which one cannot generalize. It depends entirely upon the total set of relative circumstances in each particular case. One warning should be given those who propose to produce their own power: Remember that when power is bought from a public-utility company, the exact cost of each unit is known. When calculating the cost of producing one's own power, it is very easy to underestimate by overlooking some of the costs. For instance, depreciation, insurance, taxes, and interest on the investment are all costs to be reckoned with.

THE QUESTION OF MATERIALS

There are very few manufacturing industries in which the cost of materials does not play an important part. In most industries, materials constitute the predominating item. There are some industries in which materials make up the greater part of the total production cost.

In view of this situation it is easy to understand that even a slight reduction in cost of materials may well represent the difference between success and failure. There are many ways in which economies in the cost of materials may be effected, but the following three are perhaps the most outstanding:

1. Proper location with respect to materials
2. Proper plans for safeguarding and controlling the materials
3. The right kind of purchasing policies and procedures

LOCATION SOMETIMES OF DECISIVE IMPORTANCE

In discussing costs it is noted that location has been mentioned several times. In connection with most materials, location is perhaps the one outstanding factor. In some cases proximity of materials is imperative. Proximity may mean nearness in miles, or it may imply an adequate and economical method of transportation.

Frequently the product requires various types of materials. In such a case, exact calculations must be made to minimize the total cost. This is sometimes simplified by the fact that one kind of material predominates, thus relegating the other materials to a relatively insignificant position. For instance, in fruit canning the fruit is far more important than the sugar.

Once more the reader should be warned against overemphasizing any one of the cost items. Important as it is, a slight decrease in the cost of materials, because of location, may be more than offset by other locational factors. Factories are not always built close to the materials.

MATERIALS MUST BE CONTROLLED AND SAFEGUARDED

Some businessmen will become highly excited over the loss of $5 in cash but will dismiss the loss of $50 worth of materials with a real or metaphorical shrug of the shoulders. Somehow there is a prevalent idea that the loss of a certain amount of materials is rather unavoidable. Cash, they feel, must be carefully watched and controlled.

This view is of course not logical. Usually $5 worth of materials is as important as $5 in cash and should be equally well controlled by means of the proper controls and records. Here are a few things that should be done in that connection:

1. Careful inspection of quantity and quality when materials are received
2. Proper storage of materials

3. Maintenance of proper inventory records supplemented by periodic physical inventory
4. Issue materials only on the basis of properly authorized requisition slips
5. A routine of purchasing based on a record of minimum and maximum requirements
6. Work toward a standardization of parts as far as feasible

The foregoing will give adequate current information concerning the supposed condition of supplies, and this may be periodically verified by inspection even at other times than inventory dates. It does not, however, assure the best use made of the materials after they enter the manufacturing process.

Control of materials is a problem for accounting. Safeguarding and economizing the materials while in process are engineering problems. However, even here it is the accounting records that tell the story. If it is found from the records that the cost of material for making a certain article has increased, it constitutes a warning to the management that here is something that should be investigated.

Sometimes materials may be damaged or discarded through sheer waste and carelessness. At other times it is the result of poor planning concerning the most effective utilization of the materials. Quite frequently it is a matter of poor workmanship resulting in the output of an abnormal amount of goods that will not pass inspection.

An important item in the safeguarding of materials is the salvaging and marketing of what is commonly known as *scrap*. Examples of scrap are odds and ends of lumber and metals that are sometimes thrown away but which may be sold. In more prodigal days meat packers used to discard a considerable portion of the hog.

In concluding this part of our discussion, we should remember that the attempt to safeguard materials may be carried to extremes. It does not pay to spend more money on *saving* the material than the value of the *materials saved*. For instance, it would be unprofitable to have a $1-an-hour man tinker around for 5 hours to save $3 worth of material. Again it does not pay to save materials to the extent that the result is an inferior product.

THERE REMAINS THE QUESTION OF PURCHASING

It has been pointed out how some of the economies in the cost of materials can be brought about by choice of location, adequate controls, and judicious safeguarding of the materials. Further economies may be effected through wise purchasing policies and procedures. The chief questions involved are what to buy, where to buy, when to buy, how much to buy, and on what terms the purchases should be made.

In making a particular type of product, there are instances when there is not much choice as to what to buy. In some cases several variations may be possible. Standardized parts should be used whenever feasible. Slightly cheaper material may serve a given purpose equally well. The question of whether to make certain parts or buy them ready-made is important.

Where and when to buy depend largely upon one's information about the market. Statistical information and long experience may help the buyer determine the best time to make his purchases. It may be supposed that the place to buy is wherever a given item can be bought at the lowest price. This is not necessarily the case. Promptness of delivery, reliability of the firm, willingness to render service, continuous adequacy of supply—these may sometimes be more important considerations than a slight difference in price.

The quantities in which a manufacturer should buy depends upon

1. Production requirements
2. The condition of the market
3. Probability of a constant supply
4. The cost and problem of storage

The prime essential is always an adequate supply. No mill or factory can afford to run the risk of a shutdown because of a shortage of supplies and materials. When the minimum supply is provided, the question of how much more stock to carry becomes a matter of business expediency.

When prices are seasonal it may be profitable to stock up at the low price, unless the cost and inconvenience of storage more than offset the gain. The probability of spoilage or deterioration must also be considered. The possibility of financing is often an important consideration. It takes additional capital to buy up for future use.

Some people advocate what is known as *hand-to-mouth buying* as a normal policy. It is claimed that this always avoids risk and speculation. This is not always the case. If purchases are only for immediate needs, there is the risk of losing the profit that may have been gained from buying in large quantities or in a period of low prices. Furthermore a chance is taken of being short of certain supplies at a time when the market is unable to furnish them.

The terms on which purchases are made are either for cash or on the basis of some kind of credit arrangement. If the concern is financially able to do so, purchases for cash are usually preferable. The extra inducements in the form of cash discounts and other concessions generally yield a return sufficient to warrant such a practice.

SUMMARY

Successful business operations depend upon an adequate volume of sales at a satisfactory margin of profit. The two must always go together. The business may be successful by reason of large volume and small margins, or by reason of a relatively high margin at the risk of smaller volume of sales. The adjustment of these two factors is a matter of business judgment.

In any case it is profitable to reduce production cost to a minimum. This is not dependent upon any one factor but upon the combination of several factors. Production cost involves materials, direct labor, and the various manufacturing expenses. In addition to this the over-all situation requires a consideration of selling and administrative expenses.

The two outstanding production costs are materials and labor. Labor cost is such a complex topic that all of Chapter 13 will be devoted to its discussion. Because of its relative importance, even a small percentage of savings in the cost of materials is of considerable consequence. The location of the factory frequently plays an important part in the cost of material. Other important factors are proper safeguards and control and proper purchasing policies and procedures.

Some other important elements of costs are power, repairs, and depreciation. Repairs and depreciation may loom among the most important items in a business employing a large amount of expensive machinery.

QUESTIONS FOR REVIEW

1. Are *both* volume and adequate margin necessary for success in business?
2. In this respect, what are some of the problems of a manufacturer?
3. Is this statement true: "Profit is dependent upon and results from a large volume of sales"?
4. Does purchasing goods at a relatively low cost result in profit?
5. Does manufacturing goods economically result, of itself, in a profit?
6. What "residue" is actually the "profit"?
7. May a company have high labor costs and still be "successful" in making satisfactory profit?
8. Will the extent to which machinery is used probably affect the relative amount of labor cost?
9. Will the use of much expensive machinery increase the cost of manufacturing?
10. Would you consider an annual profit of a million dollars to be "good"? If this amounts to only 4 per cent of sales would you possibly say that the rate of profit is unusually high?
11. What is the final measure for judging the adequacy of profits?
12. Does it make any difference what the margin of net profit on sales is if the percentage of return to the proprietors is good?
13. On a profit-and-loss statement, may the item "other expenses" ever be of any great significance to the management?
14. What is the difference between repairs and depreciation?
15. Are repairs and depreciation both costs? Do they both involve current expenditures?
16. In what types of business are repairs and depreciation likely to be rather important?
17. When a machine is purchased, what policy may then need to be decided relative to future repairs? What might have to be decided that would affect the rate of depreciation charge?

18. Is there any relation between repairs and depreciation?
19. What types of expenses are included under the heading of *power*?
20. Is power ever an important expense to a business?
21. What choice may face a manufacturer regarding the cost of his power? What warning may well be heeded in making the choice?
22. Mention three important methods of assuring economy in material cost.
23. What is meant by proximity of materials?
24. When there are many materials to be purchased from many different areas, what may determine the location of the business?
25. Are factories always built close to the main materials to be used?
26. Is the theft of $50 worth of materials as serious as the theft of $50 in cash?
27. Name six types of control important in economizing on materials costs.
28. What is meant by scrap? What relation does this bear to materials costs?
29. What are perhaps the four chief questions involved in purchasing?
30. Should materials always be purchased at the place that will quote the lowest price for a given quality?
31. What disadvantages may result from hand-to-mouth buying? What advantages may it have? Does it eliminate risk and speculation?

TERMS AND PHRASES TO DEFINE OR EXPLAIN

1. Volume
2. Repairs
3. Cost
4. Power
5. Gross profit
6. Profit margin
7. Margin on sales
8. Depreciation
9. Purchasing policies
10. Return on investment
11. Scrap
12. Control of materials

QUESTIONS FOR DISCUSSION

1. Which is likely to be more profitable, a high margin with a low volume or a low margin with a high volume?
2. Is it possible actually to increase profits as a result of paying higher wages?
3. If profit is the "residue" after paying all costs, is there any way of *eliminating* the risk associated with profit making?
4. What cost items may be relatively high, individually, but still be a portion of the cost of a very efficient business?

5. Are there any costs that are likely to be rather low as a result of certain other costs being relatively high?
6. To what extent does the margin on sales vary with different types of businesses?
7. In what types of business would a very narrow margin of profit on sales be rather dangerous?
8. If a profit-and-loss statement lists depreciation among the expenses, do you think you could find entries to substantiate this expense among the current entries in the record of cash paid out?
9. If an addition is built on a building would this be classed as a repair?
10. Over a long period of time, would the net profit of a business likely be about the same regardless of whether or not depreciation was included in the costs of each fiscal period?
11. Name some types of materials that customarily are *very* carefully controlled. Also name some that frequently are not carefully controlled.
12. Discuss this statement: "Cost records on materials are relatively useless; it is too late to call the fire department after the house is destroyed."
13. Mention types of scrap that have been salvaged as a war measure but that previously were often wasted. Why were they previously wasted?

CASE PROBLEMS

1. Two hat manufacturers make almost identical hats. Also each produces the hat at a total cost of $1.50 f.o.b. place of manufacture. One company sells the hat at $1.75 and has an annual volume of 700,000 hats. The other holds its price at $2.00 but gets an annual sales volume of only 300,000 hats. Which price policy produces the greater total net profit?
2. The Brikard Manufacturing Company has total proprietorship of $100,000. Its total sales for the year 1946 was $1,000,000 and its net profit was $10,000. The general manager feels that the net profit is inadequate and insecure, but the board of directors tells him that the stockholders are satisfied and requests him to continue present policies. Why do you think this difference of opinion may exist?
3. The Acme Manufacturing Company and the Frontal Manufacturing Company are competitors manufacturing cigars of comparable quality. The sales volume of the two companies is almost identical, yet total direct labor cost for the Acme Company is twice what it

is for the Frontal Company. What possible reasons may there be for this difference?

4. The Jones Company and the Moffit Company are similar types of businesses with equal capitalization. Each also has $50,000 invested in buildings and $20,000 invested in equipment. In 1944 the profit-and-loss statement for the Jones Company shows $6,000 depreciation expense plus $500 repair expense, whereas the statement for the Moffit Company shows $3,000 for depreciation and expense plus $3,000 for repairs. What difference in basic policies may account for these differences in expenses?
5. Barton and Jenson are partners. Barton takes care of the office and keeps the records. Jenson objects to the profit-and-loss statement that is submitted because it does not show any expense for depreciation on building or equipment. Barton replies that he has listed therein all "outlays," and that in his opinion it is both unwise and untruthful to list anything as an "expense" if no cash has been paid out for it. Which partner is correct in his contention?

SUGGESTED PROJECTS

1. Investigate and report to the class on the system used in your college in requisitioning, buying, and controlling the inventory of supplies.
2. Consult the "Accountants' Handbook" or some similar reference or authority and report to the class on variations in the useful life of various types of buildings for depreciation purposes.
3. Check through recent issues of *Accounting Review* or some other magazine suggested by your instructor and report to the class the general nature of articles dealing with the recording of depreciation or repair expense. (You need not attempt to master any technical accounting concepts that may be presented.)

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13. Labor costs

PREVIEW: Labor, as a production cost, presents a number of problems not inherent in other costs. Types of wage payments are of considerable importance in determining labor costs. There is a direct relationship between production costs and wages. What are some of the problems presented by labor that are not inherent in other production costs? What are the various systems of wage payments? Do low wages ensure low production costs?

PERSONNEL PROBLEMS: A BROAD CONCEPT

Personnel problems in the broadest sense of the term include any questions arising in connection with dealing with *persons.* In a narrower sense they embrace only relationships between an employer and an employee. For instance, questions arising concerning a hired man on the farm or a housemaid in a home are personnel problems. It is of course in large enterprises that personnel management becomes of vast proportion.

Personnel management deals with such problems as the selection, employment, supervision, promotion, and discharge of employees. In addition and perhaps of even greater importance are the questions of wage payments, working conditions, and all steps taken to promote contentment, loyalty, and efficiency on the part of the workers. This involves such matters as labor organizations and labor legislation. However, since this unit (Unit Four) is devoted to the question of manufacturing costs, the topics of organization and legislation will be mentioned only incidentally. A fuller discussion of these topics will be presented in later chapters.

LABOR INVOLVES HUMAN AND SOCIAL ELEMENTS

In attempting to treat labor as purely a *cost element,* certain difficulties arise not encountered when discussing other factors of cost. In the management and control of materials, supplies, repairs, depreciation, and power, inanimate objects and relatively impersonal situations are dealt with. Furthermore predictions and plans can be made on a mathematical and mechanical basis with rather certain knowledge of the outcome. Finally no one but those directly connected with the business ordinarily care how these items are handled.

The question of labor cost cannot be approached in quite such a calculated and cold-blooded fashion. With labor there are human and social elements involved. By reason of legislation, social approval or disapproval, and the employer's own conscience it is not always possible to choose the procedure that would clearly be the best from a strictly profit standpoint.

There is another reason why labor cannot be dealt with precisely the same as machines and materials. A machine when in good order reacts precisely the same way under all conditions. If we apply certain specific processes to a given material, we know exactly what the outcome will be. We do not have such precision in connection with labor. The probable human reaction to various stimuli cannot be determined by means of a test tube.

Notwithstanding the above difficulties the case is not hopeless. Experience has shown that within reasonable limits that which is good for labor and is socially desirable is also generally conducive to greater profits to the employer. Although, as has been explained, human reaction cannot always be *precisely* determined, there is available a considerable amount of valuable experimental knowledge. To a large extent, personnel management has become a science, though by no means an *exact* one.

LABOR MAY BE DIRECT OR INDIRECT

Although not necessarily pertinent to our present discussion, it is well to mention that, from the standpoint of their contribution to particular products, labor may be classified as *direct* and *indirect.* Direct labor represents work that is applied specifically to the making of particular products. Indirect labor is all other labor that may be necessary to facilitate the direct labor and make possible the smooth functioning of the plant as a whole.

For instance, a factory is producing hammers. A large portion of the workers will be engaged in making the parts that go into hammers; others will assemble the parts; all this constitutes direct labor. In addition to this we must have janitors, watchmen, and timekeepers. Necessary as this work may be it is impossible to assign this type of work directly to the production of any particular hammer or lot of hammers. Such labor is called *indirect labor.*

LOW WAGES NOT ALWAYS ECONOMICAL

Subject to what we have said regarding human and social implications, attention shall be turned chiefly to the question of how to derive the maximum profit from expenditures for labor. The question shall be considered rather strictly from the businessman's standpoint. This is not necessarily done because the businessman's interests are paramount, but because this unit is primarily concerned with the consideration of profitable production.

The first thing to keep in mind is that low wages are not necessarily desirable even from the viewpoint of a particular employer. A superficial view of the situation might lead one to the conclusion that from a profit standpoint the whole solution would consist in paying as low wages as possible and then working the employees to the limit.

The situation is not quite so simple even from a pure profit standpoint. Wages that are too low and working conditions that are too bad may prevent the earning of high profits—the very purpose for which they were imposed. On the other hand, wages may become so high that the business cannot absorb the cost and thus may result in the elimination of profits and finally the elimination of the business itself. The happy median, for both employer and employee, lies somewhere between these two extremes.

Subject to reasonable limits, there are several reasons why it may pay an employer to improve wages and working conditions beyond those compelled by competition and other surrounding circumstances. A few reasons for relatively high wages and good working conditions are as follows:

1. Will attract a better group of workers. The best workers gravitate toward the best paid positions.
2. To a certain extent, good wages and working conditions will of themselves increase the efficiency of the workers.
3. Less labor turnover. Well-paid men will stay on the job. It costs money to train new employees.
4. Less labor trouble.
5. Contented workers will boost the company. This may have far-reaching results in building good will.
6. Everything else being equal, the public tends to favor a concern that treats its employees fairly. This is especially true of those in other laboring groups.

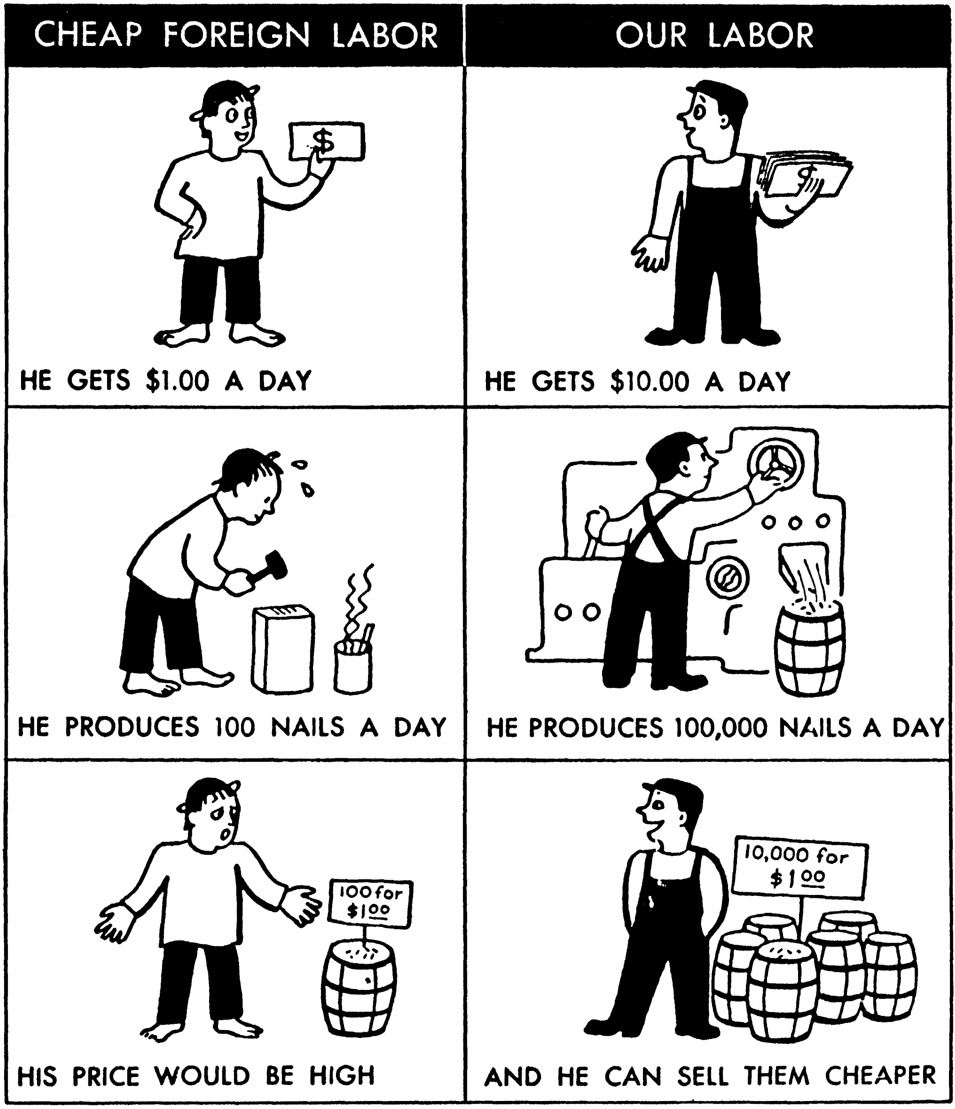
The preceding list represents the kind of principles that are becoming more and more a part of the thinking of management. The number of employers who simply exploit their workers for all the traffic will bear is rapidly becoming a dwindling minority.

HIGH WAGES ARE SOCIALLY DESIRABLE

Since the businessman is himself a member of society, whatever benefits society will tend to benefit him. This is an additional reason why he should favor a rather high level of wages. The social reasons for good wages are in part the same as those listed in the previous section and may be stated as follows:

1. Good wages and favorable working conditions improve the efficiency of the workers.
2. Opportunity is afforded to take time off for improving one's education and developing one's skill.
3. Less labor trouble. Workers are more contented.
4. Workers become better customers for the products of industry. Mass production presupposes mass consumption by all groups of people.
5. If employers share their good fortune with the employees, it strengthens the latters' conviction that both are working toward the same end.

6. If wages are high, there is a tendency to introduce more labor-saving devices and methods and thus promote industrial progress.


CHEAP FOREIGN LABOR
OUR LABOR
$
HE GETS $1.00 A DAY
HE GETS $10.00 A DAY
HE PRODUCES 100 NAILS A DAY
HE PRODUCES 100,000 NAILS A DAY
100 for $1 00
HIS PRICE WOULD BE HIGH
10,000 for $1 00
AND HE CAN SELL THEM CHEAPER

IS CHEAP FOREIGN LABOR A MENACE? (Reproduced from "What Foreign Trade Means to You," by Maxwell S. Stewart, courtesy of the Public Affairs Committee, Inc., New York.)

It is sometimes difficult to distinguish between cause and effect, but it is an interesting observation that countries with high wages invariably have a high rate of production. What does this mean? Which is *cause* and which is *effect?* Are wages high because production is high, or vice versa?

THERE ARE VARIOUS METHODS OF WAGE PAYMENTS

There was a time when nearly all wage payments were on a time basis. The worker was paid on the basis of the length of time devoted to the task. This form of payment is still very common. As a matter of fact, there are many occupations where this is the only method that could be used, since the result of the work cannot be broken up into definite units of production.

When the product resulting directly from the work can be broken up into determinable units, a method of wage payment known as *piecework* may be employed. This means that the worker will be paid in proportion to his output rather than on the basis of the time spent at his task. For instance, in assembling hammers he may be paid a certain amount per hammer.

Even when piecework is possible, there may be instances when the net results may be better if the worker is on a time basis. However, when quantity output per man is especially important, piecework would certainly seem to afford a motivation that is lacking when time is the sole basis for wage payments. It is possible that piecework is also fairer to the workers, since it offers rewards in proportion to the individual's actual accomplishments.

Although piecework is in itself an incentive, what is known as *incentive wages* go a step further. Straight piecework pays a flat rate for each unit produced regardless of the amount of output. The so-called "incentive wages" provide some kind of a *premium* for people who produce more than the standard amount within a given time.

Results from Wage Incentives[1]

In the Chicago area, a group of 62 companies reporting results from incentive-wage plans showed an average increase above past performance of 38.28 per cent, with an average decrease in unit costs of product of 14.62 per cent, while workers' earnings *increased* 17.11 per cent.

Typical examples of the functioning of incentive-wage systems, taken from these cases, are given in the table on page 195.

On the basis of increased productivity, the introduction of incentive-wage plans in the 62 plants was equivalent to adding 4,014 skilled workers. Moreover the increased production was obtained without en-

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[1] From the *Nation's Business*, July, 1945.

Type of production	*Gain in pay, per cent*	*Gain in output, per cent*	*Drop in unit cost, per cent*
Switch gears	3	3	0
Gears and motor parts	12	7	44.5
Fans and blowers	10	10	0
Condensers, radio	3.2	3.2	0
Laundry	14.5	22	10
Wood products	18.5	27.5	14.1
Corn products	9	13	4
Radio and radar	20.6	78.7	36.9
Pistol belts	25	25	0
Canned foods	2	10	8
Aluminum castings	56	71	7

dangering or sacrificing quality. Quality and precision are "musts" when you are manufacturing radar equipment, radio parts, gears, condensers, fans, motor parts, and aluminum castings.

FREDRICK W. TAYLOR STARTED SOMETHING

Back in the middle teens of the present century, Fredrick W. Taylor became interested in incentive-wage payments. Taylor earned the reputation of being the "father of modern scientific management." He devised a method that has been called the "Taylor incentive-wage plan." This plan marked the beginning of a series of methods looking toward the motivation of increased unit production per man-hour.

The essence of the Taylor plan is to give the fast worker a higher rate for all units he produces than the amount paid per unit to a relatively slow worker. To illustrate, let us suppose that the normal output per man is found to be 100 a day. A person who produces 100 or slightly more or less will get 4 cents per unit. If he makes, say, 90 units or less he gets 3½ cents. If he makes 110 units, he will get 5 cents per unit and will earn $5.50 a day. The discrepancy between the fast worker and the slow worker is so great under the Taylor system that a worker who does not get up to at least the standard output will have a tendency to leave his job entirely.

THERE ARE OTHER INCENTIVE PLANS

Many efforts have been made to modify Taylor's plan in order to fit different situations. In many of these methods of wage payments one purpose seems to be to mitigate somewhat the severity of the original Taylor plan. Two of these plans will be mentioned:

1. The Gantt task and bonus system
2. The Halsey premium plan

Under the Gantt plan job standards are set, and if the employee does the work in less time he receives a bonus. There is a minimum rate set that will be paid to even the slowest worker. After the worker has reached a certain percentage of efficiency (commonly 66⅔ per cent) he begins to get a bonus on top of the minimum rate. The bonus is on a sliding scale, ranging from 10 to 30 per cent as the worker approaches 100 per cent efficiency. The advantage of the Gantt plan over the Taylor plan is that it gives some inducement even to a slow worker to remain on the job and try to improve his record.

The Halsey premium plan involves setting up a standard time for each task, based upon observation and experience. On the basis of this a person is paid an hourly rate. If he completes the job in less than the standard time, he is given a premium of say 50 per cent of the wage value of the time saved.

The above rather complicated plan can best be shown by means of an illustration. The standard time for a job is 8 hours. Suppose the regular rate of pay is 50 cents an hour. A worker completing a job in 8 hours would get just 8 × $0.50 or $4.00. If he did two jobs within the 8 hours, he would get the regular pay of $4.00 plus 50 per cent of the hourly rate of the 8 hours saved, or $2.00. Thus he would get $6.00 for the 8 hours of work.

Both the Taylor plan and the Gantt plan impose a rather heavy penalty upon the slow worker. The Halsey plan, on the other hand, may seem to offer too little incentive to fast work. It would be unwise to attempt to generalize upon the relative merits of these plans. The plan that might be excellent under a given situation could be entirely impractical in another.

THERE ARE OTHER INDUCEMENTS BESIDES WAGES

Adequate wages wisely distributed on an incentive basis constitute the best guaranty of a contented and efficient group of workers.

However, the wage plan is not everything. Working conditions, security of employment, seniority rights, insurance, retirement plans, share in the management, and other inducements are frequently of considerable importance.

Some concerns go a long way toward providing various kinds of services for their employees. Rest rooms, recreation facilities, meal service, and plans for mutual helpfulness among the workers are some of the projects that may be attempted. Other employers try to furnish opportunities for education and vocational advancement. Most of these plans must be administered with care. In some cases they may have a negative effect. This is especially true if they are made compulsory. In other cases the cost is too great in proportion to the degree of labor contentment created by their application. In all cases it should be remembered that nothing quite takes the place of a fair and adequate wage schedule. If the latter is not forthcoming many employees are inclined to look upon all the other inducements as mere efforts to provide sops to lull them into complacency.

QUESTION OF LOCATION ENTERS IN

Once more we feel impelled to call attention to location. Owing to variations in the cost of living and other environmental circumstances, $30 a week in one place may be as good as $40 a week in another. The cost of living alone may vary as much as 20 per cent. In addition to this, a desirable climate, getting away from congestion, social surroundings, educational facilities, etc., loom high in many people's minds. From the viewpoint of the employer it should also be remembered that some places, for various reasons, are less subject to labor disputes.

The foregoing does not necessarily mean that low labor cost, important as it is, should be the prime determinant in selecting a location. As a matter of fact it seldom is. Industry tends to centralize by reason of other favorable factors. In fact that is the reason why employers are willing to pay high wages in such areas.

Finally, it should be remembered that wages are not the only factor involved in connection with labor. Availability and flexibility of the supply of the right kind of labor may be equally important. This is one of the many reasons why particular types of industries tend to cluster around certain centers.

PERSONNEL RELATIONSHIPS SHOULD BE SCIENTIFIC

In the present unit we have frequently referred to *scientific management.* Procedures based on exact and adequate knowledge are as important in the field of labor as anywhere else. From a profit standpoint, employment problems must be based on something more definite than mere hunches and generalizations from isolated instances. Scientific management in personnel problems involves a carefully conducted study of all the labor factors involved plus their relationship to the management of the enterprise as a whole.

SUMMARY

The question of labor presents difficulties not encountered in connection with other production costs. Labor involves the human factor. Human behavior cannot be accurately judged. Social obligations are also present. The task of dealing with these problems devolves upon those in charge of personnel management.

Notwithstanding these considerations, an employer must do what he conscientiously can to make labor yield a reasonable profit to the business. This does not mean that he must be penurious in his wage payments. Reasonably high wages may be more profitable than low wages. Other inducements to make the workers more contented and efficient may also be well worth the extra cost.

During the last few decades various types of incentive-wage payments have come into prominence. The general idea of these plans is to pay the workers at a certain minimum rate for slow production and then to increase the rates for the faster workers.

QUESTIONS FOR REVIEW

1. With what types of problems does personnel management deal?
2. Which of these personnel problems are perhaps of greater importance?
3. In what way does labor as a cost element differ from materials, supplies, etc.?

4. How does a human being differ from a machine insofar as managerial control is concerned?
5. Can a manager predict in any degree what reactions his employees will have?
6. Distinguish between direct labor and indirect labor.
7. From a strictly profit viewpoint, and of course subject to reasonable limitations, why may high wages and good working conditions be economical?
8. From a social viewpoint, why are high wages and good working conditions desirable?
9. If high wages and high rates of production go together, can you say which is cause and which is effect?
10. Under what conditions is time the only available basis for wages?
11. Under what conditions may piecework be a desirable basis for wages?
12. What were the principal features of the Taylor incentive-wage plan?
13. Describe the Gantt task and bonus system of wage payment.
14. What advantage might the Gantt plan have over the Taylor plan?
15. What are the general features of the Halsey premium plan?
16. What other important inducements may labor have besides an adequate and fair wage-payment plan?
17. What services do some concerns furnish for their employees?
18. Why must such plans for services be managed with great care?
19. Of what significance may the question of location be to workers?
20. From the viewpoint of the management, what effects may location have on labor supply?
21. What is meant by scientific management of personnel problems?

TERMS AND PHRASES TO DEFINE OR EXPLAIN

1. Piecework
2. Gantt plan
3. Halsey plan
4. Taylor plan
5. Hourly wage
6. Human nature
7. Indirect labor
8. Labor turnover
9. Labor trouble
10. Incentive wages
11. Retirement plan
12. Seniority rights
13. Personnel management
14. Scientific management
15. Labor legislation
16. Availability of labor
17. Security of employment

QUESTIONS FOR DISCUSSION

1. To what extent is the science of personnel management dependent upon or similar to the field of psychology?
2. What are some of the personnel problems in selection of workers?
3. What are some of the personnel problems connected with the promotion and discharge of workers?
4. A trained and skillful teacher can predict with a fair degree of accuracy what a class of students will do under given circumstances. To what extent can a competent personnel manager likewise predict the reactions of a group of employees?
5. During wartime do you believe that an enlisted Wave working as Yeoman or Storekeeper in a naval office is doing essential war work? Does the same reasoning apply to the indirect labor done in a factory?
6. If unskilled labor were receiving $2.50 per day in a given factory (in normal times) do you think it is very likely that the net profit of the factory would *increase* if all unskilled laborers were raised to a minimum of $5.00 per day?
7. Why will good wages tend to increase the efficiency of the workers?
8. If incentive-wage plans are good, why is it that more businesses do not make use of them in some form?
9. Would you say that incentive-wage plans are the same as "profit sharing"?
10. What are some of the problems that would be involved in setting a standard time for a task, as is done under the Halsey plan?
11. Some workers feel that services furnished them by the employer are actually paid for by themselves through lower wages. To what extent do you think this is likely to be true? If it is true, would the business likely profit more by spending the amount on wages and discontinuing the services?
12. Which of the many inducements other than wages do you feel are most important to workers? How may your answer vary as between different groups or classes of workers?

CASE PROBLEMS

1. The Fairchild Department Store pays its employees what it considers to be the prevailing wages for work such as theirs. The employee turnover has always been rather high, however, resulting in employees who, on the whole, are not too skilled in their work.

What are some of the things that this store *might* find worth doing to remedy the situation?

2. The Case Manufacturing Company has always had much of its work done by hand methods and, realizing its dependence upon the continuous efficient work of its employees, has maintained a policy of paying relatively high wages. During 1944 its employees are organized by labor leaders and in due time demand an increase in pay, pointing out that the cost of living has risen considerably since they had their last increase in pay. Owing to ceiling prices on its products, the Case Company is unable to grant higher pay and still operate at a profit. What would seem to you to be the best thing to do about it?
3. The Pryce Natural Products Company has seasonal labor demands and must depend on hand work for many of its processes. It was located in the mountains of Tennessee primarily because mountaineers and their families were available for employment during the rush season and could be hired at low wages. However, labor organizers have since forced a closed-shop policy on the company, and present labor laws now force the company to pay much higher wages. Since most of its expenses consist of wages, it now is faced with bankruptcy if it long continues production under present policies. What can the Pryce Company do about it?
4. In spite of the fact that the Mayfair Company is paying its employees wages that definitely are high, it has reason to believe that the employees are not satisfied and that they are not turning out as much work per employee as are employees of competing companies. A new personnel manager is hired to see what he can do to remedy the situation. What would you suggest that he do?

SUGGESTED PROJECTS

1. Check through recent issues of the *Personnel Journal* or some other magazine suggested by your instructor and be prepared to report to the class on the general nature of articles you find dealing with the particular "area" below that is assigned to you.

   a. Personnel records
   b. Interviewing and hiring employees
   c. Testing applicants for employment
   d. Wages and wage-incentive plans
   e. Profit-sharing plans
   f. Retirement plans for employees

- *g.* Training employees
- *h.* Guarding the employees against accidents and health hazards
- *i.* Labor laws
- *j.* Security for employees
- *k.* Labor turnover
- *l.* Recreation and convenience facilities for employees
- *m.* Employee participation in management
- *n.* Other areas not included in this list

2. Check through a recent issue of *Monthly Labor Review* and report to the class the nature of the information to be found therein.
3. Check through recent issues of the *Nation's Business* and summarize briefly for the class the ideas you find discussed therein relating to labor problems.

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Unit Five • MARKETING THE GOODS

14. *Marketing in general* 205
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16. *Types of marketing units* 239
17. *Sale of services* 255
18. *Marketing and consumer cooperatives* 265

14. Marketing in general

PREVIEW: Marketing involves the problem of getting goods from the producer to the consumer. There are many middlemen participating in this complicated process. Marketing is largely responsible for consumers having access to commodities today that were not available fifty years ago. Why is marketing considered a modern necessity? Are there too many middlemen?

WHAT IS MARKETING?

On the sunny slopes of some of our southern and western states, there is grown a marvelous fruit known as the *orange.* This delectable and health-giving food would continue to be kissed by the sun until it spoiled were it not for the process of marketing. If no one but the local people could enjoy it, the major portion of the crop would not be picked.

The foregoing is a good example of what we mean by marketing. Marketing, in a broad sense, may be defined as all efforts directed toward transferring commodities from producers to those who want to use them. This definition includes transportation, although some writers on the subject treat transportation under a separate heading and speak about *marketing* and *transportation.* In this discussion transportation is considered as an integral part of marketing.

THERE ARE MANY DIFFERENT MARKETS

The word *market* may be used loosely to designate a variety of situations. There are general markets as well as specific ones. The following are examples of different types of markets:

1. Any place where particular things are bought and sold, such as a meat market. We generally refer to such an establishment as a *market place.*
2. With respect to a given commodity. Thus we speak about the grain market, the livestock market, stock market, etc.
3. A region offering a demand for goods. Examples of these are the midwest market, the domestic market, the foreign market.
4. The type of selling agencies. We may mention the wholesale market, the retail market, and the mail-order market.
5. The price situation. For instance, we may say that the market for a certain commodity is strong, weak, or irregular.

The various implications of the same word will not ordinarily cause any confusion, since the context will usually indicate the meaning.

MARKETING—A MODERN NECESSITY

In the Middle Ages there were those who made little distinction between merchants and robbers. Both were looked upon pretty much as social parasites serving little if any useful purpose. In our age we no longer hold this view, and merchandising is a highly respectable occupation. However, the idea still prevails in some quarters that the man who *sells* the goods is not quite so useful as the person who *makes* the goods. The farmer is especially singled out as "the person who feeds us all." As a matter of fact there would be pitifully little feeding done in our modern society if someone did not step in to process and pack the goods, transport them to the places needed, and make them available for sale in the retail market.

Let us return to our example of oranges. A housewife in Chicago would never see one of these oranges were it not for the presence of middlemen. Chicago is a long way from the orange groves, and the process of effectively distributing oranges to each of millions of consumers is a complex task.

The need for merchandising and transportation multiplies whenever a certain product must be processed before it is put to final use. Reverting once more to farm products, it will be found that relatively few of these commodities are consumed in their original form. The wheat raised by the farmers is not consumed as wheat.

It is sent to the millers to be converted into flour. The larger portion of the flour is then sold to bakers to be turned into bread and other bakery goods. These commodities are then sold to the ultimate consumer. Each step requires selling and transportation. The need for these transactions again shows that original production, processing, and marketing are all indispensable links in the same chain for supplying the need of the consumer.

ARE THERE TOO MANY MIDDLEMEN?

The process of marketing is carried on largely by a group of persons known as *middlemen.* Writers are not entirely unanimous in their definition of the term *middlemen.* Some include only dealers who stand between the producers and the retailers. Others include the retailer as well. It is in the latter sense that we shall use the word.

When people say that there are too many middlemen they may mean either one of two things:

1. Too many in each group; for instance, too many groceries, too many drugstores, too many department stores, etc.
2. Too many steps between the producers and the consumers. For instance, some people say we may as well eliminate the commission man, or the wholesaler, or both.

In connection with the first point, some good arguments might be advanced to show that marketing could be carried on more efficiently and economically if there were not so many people competing for a limited amount of business. For instance, why have 100 grocery stores in a small city when 25 could easily handle the business and, at the same time, maintain healthy competition? There is much food for thought in this question, but we should not unduly jump to the conclusion that small retail stores are an evil. We shall postpone a further discussion of this topic till we consider retail stores in Chapter 16.

In talking about the second point, many people take an attitude approaching dogmatism. "Of course, there are too many middlemen," they say. They point out with something resembling horror that from the time oats pass from the farmer's bin until they are served as oatmeal to a customer in a city restaurant they have passed through a dozen hands. Elaborate figures are shown to the effect that oats for which the farmer received ½ cent become 15 cents when served to the city customer. The implication is frequently left that the difference is largely waste—if not downright robbery. Have the farmer and the city customer both been gypped?

HERE IS THE OTHER SIDE OF THE STORY

In considering whether or not we have too many middlemen, the first fundamental fact to grasp is this: *We can eliminate middlemen, but we cannot eliminate functions.* In getting the oats from the farmer to the restaurant customer the necessary steps incidental to processing and distribution must be performed by *somebody.* Whether this should all be done by two or three intervening groups or by a dozen groups is purely a matter of business economy.

Let us now look at the oats situation a little more in detail.

We would have no objection to getting our breakfast food cheaper, nor would we necessarily begrudge the farmer an extra few cents for his bushel of oats. The only point we raise is whether or not the elimination of middlemen is the solution. Let us see what happens to the oats from the time they leave the Iowa farmer until they reach the New York breakfast table.

In most instances the farmer takes his oats to the local elevator where they are *graded* and *bought.* This elevator usually again *transports* the grain to central elevators where it is *stored.* The millers *buy* from the central elevators and *process* and *package* the oatmeal. The millers, facing keen competition, must employ someone to *sell* the processed oats to wholesalers, who in turn *sell* it to the retailers. Direct purchasing of the 2,000 or 3,000 items carried by the small retailer would be prohibitive. Finally, the proprietors of some small restaurants find it convenient to buy most of their food from retailers. The size of the order for each item of food does not always justify buying at wholesale. *Financing, risk,* and *assembly* take place at each point of the trip from the farmer to the restaurant.

Here, then, we have the whole story. Tracing through all the steps mentioned, it is doubtful whether any could be eliminated. *All* must be performed by *somebody.* The necessary functions are there. Again the only question is, who shall perform them? No generalized answer can be made to this question; however, it is certainly true that in many cases a somewhat long chain of middlemen may provide the most economical method. The problem tends to solve itself by the dropping out of middlemen whenever they fail to perform a necessary service. This situation develops from the fact that most buyers use the methods that to them seem the most economical. Thus, if nearly all the retailers in a certain line find it more profitable to buy directly from the manufacturers, the wholesalers will simply discontinue that line of goods.

ARE MARKETING COSTS TOO HIGH?

Roughly one-half of the total cost of goods represents marketing expenses. To many people this seems entirely too high. No doubt certain savings can be made, but one should not entertain exaggerated ideas about the possible extent of such savings. The key to economy would seem to be to analyze the situation and cut down costs on as many expense items as possible. Increasing the rate of inventory turnover, careful buying, elimination of unprofitable items, better collection methods, judicious use of advertising, education of the consumer, and economical use of space are some of the important points to consider.

The Twentieth Century Fund's Committee on Distribution made an extensive survey of the costs involved in marketing methods and came to the conclusion that "distribution does cost too much." This committee made some pertinent recommendations in three general areas where the problems of distribution costs should be attacked. The following points summarize the suggestions of the committee:[1]

I. Consumer Knowledge

(*a*) The expansion and better coordination of government agencies to provide in adequate and popular form information that consumers need for more efficient buying.

(*b*) Further progress in the elimination of fraud and misrepresentation in printed and verbal descriptions of products.

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[1] Stewart, Paul W. and J. Frederic Dewhurst: "Does Distribution Cost Too Much?" Twentieth Century Fund, 1939.

(*c*) The development of informational labeling.
(*d*) The establishment of a differentiated pricing system for retail goods.
(*e*) The wide extension for public use of the facilities of government and private agencies for testing and appraising consumer goods.
(*f*) The further organization of consumer cooperatives and consumers' group buying agencies.
(*g*) The extension and further development of courses on consumer problems in educational institutions.
(*h*) The vigorous prosecution of Federal family-budget and expenditure studies.

II. OPERATING INFORMATION AND MORE EFFICIENT PERFORMANCE

(*a*) The development and adoption through government research and organized commercial efforts of improved methods of distribution cost accounting and analysis.
(*b*) The establishment of an institute for research in consumption and distribution, under independent auspices with a liberal endowment.
(*c*) The provision by government agencies of more comprehensive, accurate, and promptly available statistics on distribution.
(*d*) The widespread expansion of analytical studies of distribution costs, methods, and results.
(*e*) The wide establishment of training courses for distributors.
(*f*) The dissemination by government agencies and educational institutions of information about the difficulties of survival in retail trade.
(*g*) Development of cooperative research and educational programs between the Department of Commerce and university schools of business.

III. COMPETITIVE RESTRICTIONS AND REGULATION

(*a*) The immediate repeal of all laws that are designed merely to preserve, or to destroy, some special group in the distribution structure, without regard for the general public interest.
(*b*) The prompt repeal of all state legislation designed to discriminate against the products of other states and to restrict the free movement of goods between the states.

(*c*) The strengthening and more effective administration of existing laws designed to prevent and destroy private monopoly, to eliminate price-fixing, and to prevent other monopolistic practices, except under government sanction and supervision.

(*d*) Permission by appropriate government agencies, under specific statutory authority, for distributors to agree on the limitation of certain costly excesses in competition where the result will be to reduce the cost to the consumer.

INTEGRATION HAS LIMITED POSSIBILITIES

Coming back to the question of the possible elimination of certain middlemen, we face the question of *integration.* Integration, in the sense that we are now using it, refers to the assumption of more functions by one concern. For instance, a large retail outlet might eliminate the services of wholesalers by performing the functions itself that are generally taken over by the wholesaler. Note carefully that this does not eliminate any functions. It merely means that the retailer himself absorbs the extra storage, transportation, risk-bearing, financing, etc., which otherwise would be taken care of by the wholesaler. The absorption of these functions does not save the entire wholesaler's margin. Whether in a given case one or the other method should be used ought to be a matter of careful study by each individual dealer.

Perfect integration would mean that one concern would carry the whole process through from the production of the most basic materials to the delivery to the final consumers. As a matter of fact such perfect integration seldom exists except on the part of a few individuals or concerns that produce in a small way for direct sale to local customers. It is not a question of integration or no integration, but rather the degree to which integration should be carried out under a particular set of circumstances.

It is a safe generalization that, in any given line of marketing, the larger the business, the more profitable it may be to carry out a certain amount of integration. For instance, a large grocery chain may buy the entire output of many factories and ship the goods to its central warehouses in carload lots. It may even undertake to manufacture some of the products that it sells. Such integration does usually result in a lower cost of goods, but it also involves higher operating expenses. At its best, profits from integration are not so great as popularly supposed.

PROFIT RESULTS FROM A COMBINATION OF FACTORS

Net profit in marketing results from selling goods at a price that will more than cover the cost of the goods plus expenses. It will thus be seen that successful marketing involves the consideration of four factors:

1. The volume of sales
2. The price at which the goods can be sold
3. The cost of the goods
4. The amount of the expenses

From the foregoing it will be noted that profitable marketing is not the result of one factor, but of several. Information for the control of these factors is provided by the accounting records. The facts derived from these records are summarized in the Statement of Profit and Loss.

The statement on page 213 is somewhat condensed, and a few relatively unimportant items are omitted. However, it will give a general idea of the setup and will indicate most of the items to be watched in order to ensure a profit. It will be noted that all income is from sales. Profits may be increased by greater sales at satisfactory prices, by reduction of costs and expenses, or by both.

MIDDLEMEN PERFORM MANY FUNCTIONS

We have indicated in a general way the indispensability of marketing. Just what the process of marketing does for us can best be understood by a discussion of the *functions of marketing.*

Marketing functions:

1. *Assembly* (*buying*)
2. *Demand creation* (*selling*)
3. *Grading*
4. *Standardizing*
5. *Dividing*
6. *Packaging*
7. *Transportation*
8. *Storage*
9. *Risk-taking*
10. *Financing*

A careful reading of the list will give some idea of the social importance of marketing. The remainder of this chapter and all of Chapter 15 will be devoted to the discussion of these various functions.

Apparel Art, Inc.
STATEMENT OF PROFIT AND LOSS
January 1 to June 30, 1947

Sales			$1,000,000
Cost of sales:			
Inventory, Jan. 1, 1944	$100,000		
Purchases	700,000		
Goods available for sale	800,000		
Less inventory, June 30	80,000		720,000
Gross profit			$ 280,000
Selling expenses:			
Salesmen's salaries	$ 80,000		
Delivery expense	20,000		
Advertising	10,000		
Store supplies	10,000		
Other selling expenses	10,000	$130,000	
Administrative and general expenses:			
Rent	$ 20,000		
Office salaries	20,000		
Office supplies	5,000		
Bad debts	3,000		
Other general expenses	10,000	58,000	188,000
Net profit from operations			$ 92,000

BUYING MUST BE CAREFULLY PLANNED

Proper purchasing policies are highly important and involve at least three factors:

1. Buying in proper quantities
2. Buying goods that will sell
3. Buying from the best sources and in the best manner

In connection with quantities, the buyer frequently has to choose among several possibilities. He does not want to overstock, and yet enough goods must always be on hand to fill promptly the customers' needs. Prices are frequently lower on quantity purchases; on the other hand it costs money to carry a large quantity of goods. The key to the whole situation is to make the purchases on any plan that will ensure the greatest possible contribution to the net profit.

It is not only a question of how much to buy, but of what to buy. What lines should be expanded, contracted, or discontinued? What should be the variety as to quality, style, and size? Is it profitable to keep on hand some slowly moving items in order to please a few customers? These are a few of the questions that present themselves. To be able to answer these questions stock and sales must be carefully watched. Upon investigation, dealers have often found that they have items in stock that are not called for more than once or twice a year. A complete line is in itself desirable, but it is also important to watch turnover, *i.e.*, the rate at which certain items are sold.

In doing his buying the merchant must always keep his customers in mind. His sales will depend upon how well he can fill the needs of all his potential customers.

WHERE TO BUY

In purchasing, consideration must be given not only to price but also to service and convenience. Purchases from a distant source may be cheaper even after adding transportation charges, but prompt delivery may be sacrificed as well as ease of making desirable adjustments. Some firms may charge a higher price but more than make it up by their fine service.

Is it better to buy close to the original sources or make use of middlemen? Here the size of the business and the nature and variety of the goods will be the deciding factors. Closely connected with this is the question of buying large quantities for storage or following a hand-to-mouth policy. Laying in large stocks of goods may be embarked upon to get quantity discount, to forestall possible shortages and price increases, or as a plan to eliminate certain middlemen's margins. When embarking upon any of these plans, the dealer should be constantly mindful of the costs and risks incidental to storage, such as rent, obsolescence, spoilage, style changes, falling market prices, and insurance.

SHOULD IT BE VOLUME OR PRICE?

It is not difficult to get any desired volume of sales if goods are sold cheaply enough. The problem is to maintain prices that will at least cover a little more than cost and expenses and at the same time maintain a satisfactory sales record. It is difficult for some to grasp the idea that a man can sell his merchandise at cost and yet make a net profit because of his big volume of sales. In this case profits are derived entirely from his large discounts on purchases.

Each businessman must decide for himself the price policy he wishes to maintain. Except in case of dishonest practices or monopoly, there is nothing inherently immoral about charging high prices. Neither is there any special virtue in charging low prices. In both cases presumably the same thing is sought—the maximum total net profit for the business. In both cases the proprietors may also be equally desirous of serving the public good.

The idea of the profitable price-volume relationship can best be illustrated by tabulating hypothetical prices with the resultant sales and the total profit. For the sake of simplicity, we shall confine ourselves to one commodity and shall ignore the probability of per unit changes in expense as volume increases:

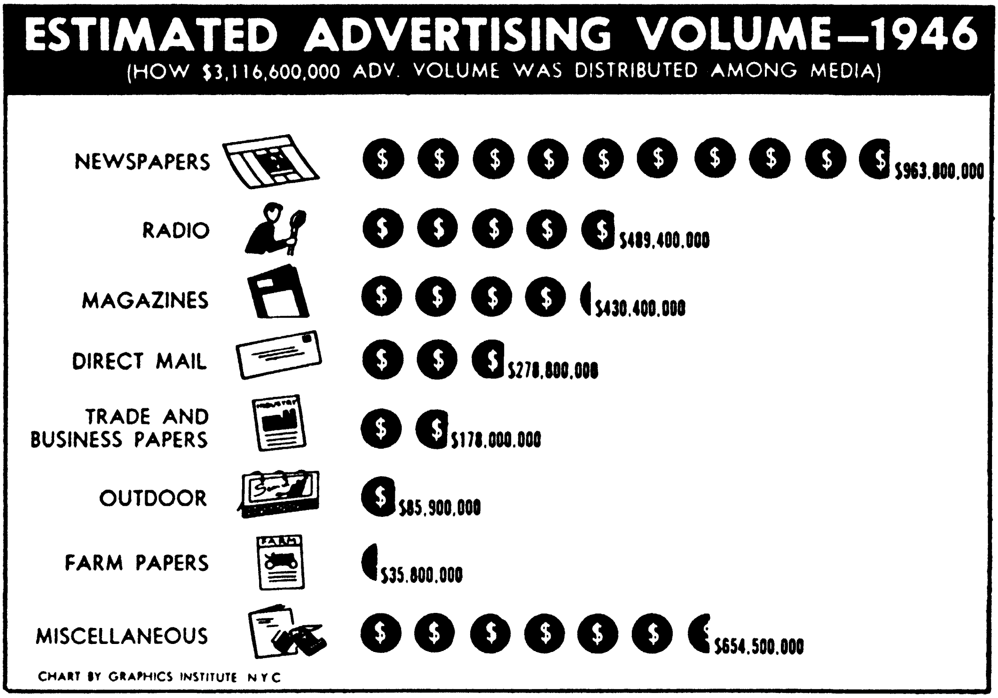
Estimate of Profits at Various Price Levels

Cost per unit	*Price per unit*	*Margin per unit*	*Sales*	*Profit*
$10	$20	$10	100	$1,000
10	15	5	150	750
10	14	4	300	1,200
10	12	2	400	800

From the foregoing it will be seen that $14 would be the most profitable price. Twenty dollars is too high; 12 is too low. The $20 price would attract only customers who want a high type of service, or who wish to buy a fashionable and exclusive product.

IT PAYS TO ADVERTISE

Sales efforts may be carried on in a variety of ways, but one of the most common methods is by means of advertising. Advertising may be defined as any method or device, other than direct personal sales approach, that attempts to place something for sale in a favorable light and thus tend to influence people to buy. The most common media of advertising are newspapers, periodicals, radio, movies, billboards, posters, circulars, handbills, and catalogues. Displays and store arrangements may also be classed as advertising.



We frequently hear that "It pays to advertise." This slogan should be restated to say, "It pays to advertise *wisely*." The volume of advertising is of little account in itself. The criteria of effective advertising are the scientific and judicious make-up and application rather than the amount.

ADVERTISING A BIG FIELD

Advertising of some type is older than recorded history, but the chief development in advertising has come during the last hundred years. The field of advertising now embraces many specialized areas and functions headed by experts in the various phases of our advertising efforts. Planning of advertising campaigns, writing of copy, illustrating, placing of advertisements, radio announcing, advisory service, and research are examples of the manifold opportunities in the advertising field.

With the better business concerns, advertising is no longer mere leaps in the dark. Rather, the advertising policies and procedures are based on carefully accumulated statistical data. These measurements of advertising efficiency are never perfect, but they are a great improvement over mere guesswork. They give reasonable assurance that every dollar spent for advertising will at least pay its own way in the form of increased profits to the business.

IS ADVERTISING SOCIALLY DESIRABLE?

Some people viewing the huge amount spent on advertising question its social values. Advertising is, however, one of the effective instruments of competition. Sellers need advertising as a means of bringing their wares before the public. Without advertising, effective competition would be hampered. Critics are more concerned about the type of advertising than the extent. Some advertising is of little help to the one who buys.

Most advertising probably is not wasteful. People are educated through advertising to make both good and bad purchases. The consumer does not always use good judgment in the things he buys. Some people are easily swayed by advertising to buy things they do not need or cannot afford. Undoubtedly advertising has promoted many desirable consuming practices. Insurance, home ownership, wise investments, savings, and laborsaving devices represent a few of the items that advertising has promoted with admittedly desirable social results.

PERSONAL SALESMANSHIP SUPPLEMENTS ADVERTISING

Good advertising facilitates sales, but it does not usually clinch the deal. This is the function of the personal approach. There are some instances where sales are made purely as a response to advertising; in other cases there is not much left to do except to take the order and wrap up the goods. In by far the majority of cases sales are finally made only by some personal sales effort.

Salesmanship is now a definite line of study that any actual or prospective salesman may profitably master. There is no doubt that any person may increase his ability as a salesman by studying some of the abundant material available on the subject. He should especially study the methods of selling his particular product. Although a study of books is valuable, it must be combined with intelligence, industry, pleasing personality, and worth-while experience.

SUMMARY

Marketing the goods is as important as making the goods. In our exchange economy one would be futile without the other. Marketing is at times wasteful, but we should not at once jump at the conclusion that it is abnormally so. We should be especially cautious about suggesting the elimination of certain middlemen. It must be remembered that middlemen may be eliminated, but their functions cannot be eliminated. Whether or not these functions should be integrated into a shorter chain of intervening middlemen depends upon the nature and size of the business and the circumstances surrounding a particular case.

QUESTIONS FOR REVIEW

1. Define marketing. Does this include the transportation of the product?
2. Identify several different uses of the term *market.*
3. Who are the middlemen?
4. Identify ten main functions of middlemen.
5. What is meant when someone states that there are too many middlemen?
6. Is there any justification for the increase in price due to the work of the middlemen?
7. Can the middlemen be eliminated?
8. If there are too many middlemen, what natural process will tend to cause the elimination of some of them?
9. If middlemen were eliminated, would their functions be eliminated? Who would then perform the functions?

10. Is the elimination of the middlemen a method of analyzing the costs of functions and, through such analysis, cutting down on expenses?
11. To what extent might integration of functions be possible? Would complete, or perfect, integration seem practicable?
12. Successful marketing involves proper consideration of what four main factors?
13. What are the three main factors involved in purchasing policies?
14. What possibilities does the buyer have in regard to the quantity to be purchased?
15. What typical problems arise in deciding what to buy?
16. What typical problems arise in deciding where to buy?
17. In deciding on marketing policies, how might a concern go about deciding whether to depend largely on sales volume for profits?
18. Does it always "pay to advertise"?
19. What relation exists between competition and advertising?
20. In what ways is advertising socially desirable? In what ways may it be socially undesirable?
21. What relation exists between personal salesmanship and advertising?

TERMS AND PHRASES TO DEFINE OR EXPLAIN

1. Marketing
2. Packaging
3. Grading
4. Storage
5. Middleman
6. Risk-taking
7. Grain market
8. Standardizing
9. Market place
10. Retail market
11. Demand creation
12. Marketing functions
13. Personal salesmanship
14. Assembly (buying)
15. Foreign market
16. Purchasing policies

QUESTIONS FOR DISCUSSION

1. In general which will perform a specific task most efficiently and effectively, a specialist at that task or a jack-of-all-trades? Does this same idea seem to carry into the field of marketing? Does this idea have any bearing therefore on the relatively large number of middlemen?
2. Do you think that one teacher who would teach all subjects would result in a desirable type of education? Might it have some advan-

tages as a system? What would be the disadvantages? Would your same reasoning apply to one middleman to perform all steps in marketing?

3. Select one of the ten main marketing functions and explain why the customer profits—either financially or otherwise—from the fact that this function has been performed. Do likewise then for each of the other nine functions.
4. Are there too many grocers? What controls the number of them?
5. To what extent are producers and consumers the same people? Are middlemen also consumers? Would you say middlemen are "producing" anything of economic value?
6. If a farmer decided to perform some of the marketing functions himself, do you think the price he would charge for his produce would be increased with each additional marketing function he performed? Do you think this additional work would in any way affect his efficiency as a farmer?
7. Should a grocery store continue to stock any item for which it has had no call for a year or so? Would your answer be the same for a jewelry store?
8. What types of items usually depend upon a large volume and small markup for profit? What types are more likely to depend on a large markup?
9. What are some of the purposes of advertising?
10. Do you think advertising has any relation to the standard of living of the nation?
11. Does a college advertise? a church? a city?

CASE PROBLEMS

1. A customer in a grocery store was overheard inquiring about the price of a certain brand of coffee. When told that it was 36 cents per pound, he angrily stated: "It's a crime the prices we consumers have to pay for coffee. We should do away with middlemen; they are the ones who cause these high prices." Assuming there were absolutely no middlemen in this country, and no one here customarily performing their functions, mention some of the "steps" (or functions) this customer would have to take in order to procure a pound of coffee. Can you estimate what this would cost him?
2. A certain retail store advertises "We manufacture our own goods and sell directly to the consumer, therefore reducing the selling

price by eliminating middlemen's profits." Discuss the significance of this statement.

3. The buyer for a certain retail store states that it is his policy to buy only sufficient goods to assure meeting current needs, for this enables him to take advantage of the lowest possible prices offered at any given time. What are the advantages or disadvantages of such a policy?
4. The McCowan Furniture Company has just completed a "bad" business year; the final report shows very little net profit. In conference with his general manager, the owner, Mr. McCowan, suggests that they must economize on expenses, and points to an expense of $10,000 during the past year for advertising, which he believes should be largely eliminated next year. However, the manager disagrees and states that if advertising expenses were increased to around $50,000 they would make a satisfactory profit. What should be the determining factors in deciding which to do?

SUGGESTED PROJECTS

1. Attempt to make a rather complete list of all the functions, services, materials, etc., that may have entered into the cost of producing a 10-cent loaf of bread. Include all whose labor may have contributed.
2. Check through several current issues of *Printer's Ink* or some other magazine suggested by your instructor and report to the class the apparent nature and purposes of the magazine. What types of information may be obtained from it?
3. In the *classified* section of your local telephone book check through the first 50 firms you find, beginning on any page, and determine what portion of them apparently represent middlemen. Report to the class those types of business which you do not consider to represent middlemen.
4. Consult the magazine *Advertising and Selling* or some other one suggested by your instructor and bring to class a list of all the types of advertising you find mentioned there other than radio, magazine, and newspaper advertising.

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15. Marketing functions

PREVIEW: In the process of getting goods from producers to consumers many functions are performed. Assembly and demand creation were discussed in Chapter 14. Transportation, storage, financing, and risk are incidental to all forms of marketing, and in most instances dividing and packaging are also present. Grading and standardization are not applicable to all marketing situations. Who performs these marketing functions? How do standards and grades help the consumer? What are some of the risks peculiar to marketing?

GRADING AND STANDARDIZING FACILITATES MARKETING

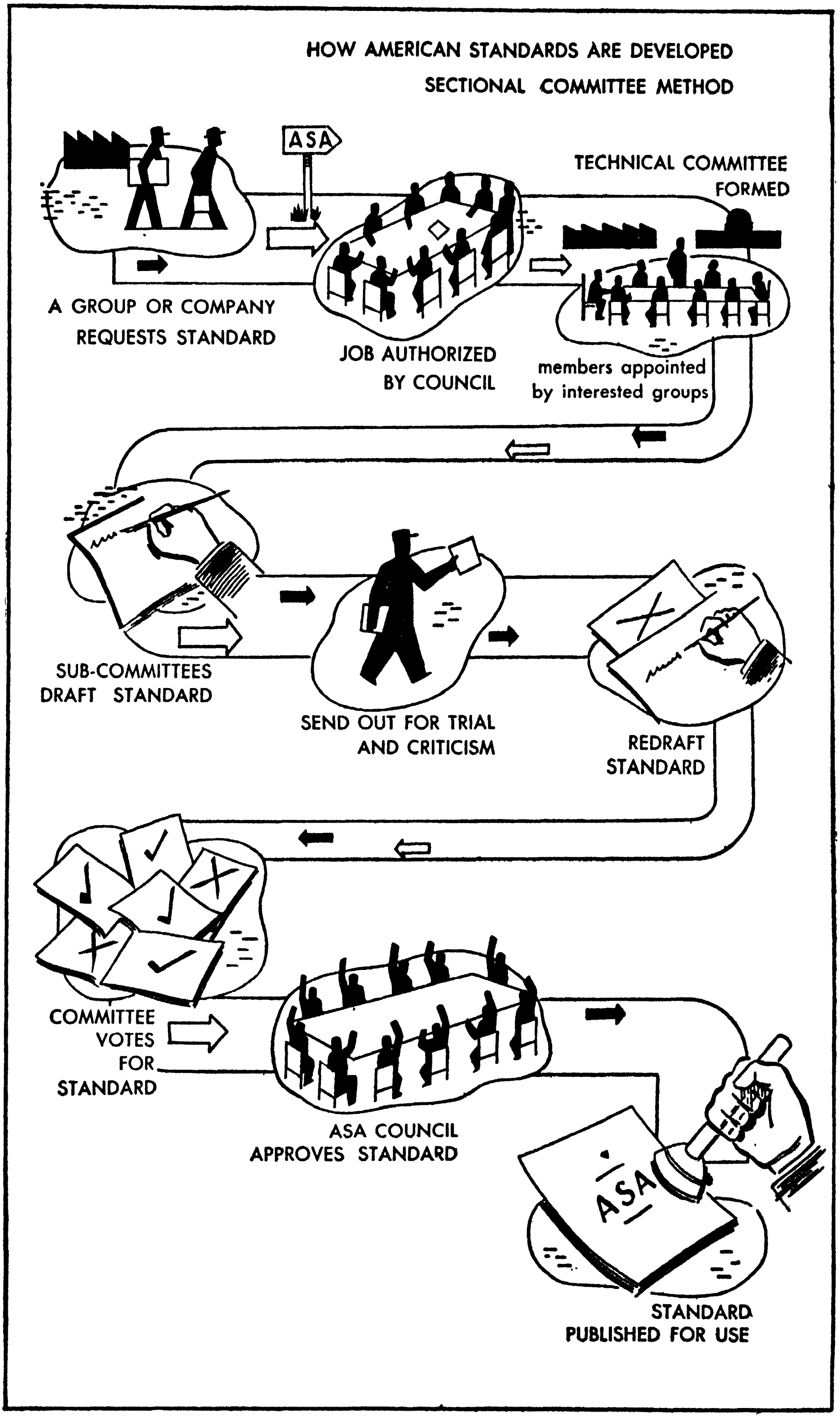
Nature provides products in a variety of shapes, sizes, and qualities. This is true whether the products come from the farms, the mines, the forests, or the fisheries. Even in certain cases of manufacturing, especially in some food products, the quality of the output may vary. Whenever this situation exists, a device known as *grading* may be employed. Grading involves sorting products in such a manner that the particular qualities of each lot will be uniform. For instance, eggs may be graded as to size, milk as to butterfat content, etc.

Standards are often established for the purpose of grading or rating goods. Standards may be based on quality or several qualities, performance, size, durability, or a combination of these factors. Standards are established and recognized criteria with which other goods are compared. The goods are then graded to meet the standard. In many cases this involves sorting as explained above. In other instances the goods may be produced in a specific manner to comply with a certain standard. Products put on the market in their natural state, such as fruits, vegetables, and eggs, are usually sorted in order to conform to designated standards. Most manufactured products are produced according to standard specifications in the first place. For instance, in making nails the manufacturer decides beforehand just what kind of nails he is going to make and then goes ahead and makes them. Except for elimination of accidental defects, there is no sorting to be done. All meet the established standard and are therefore all alike.

STANDARDIZATION CONDUCIVE TO ECONOMY

When people buy standardized commodities, they have some basis for judging what they are getting. For instance, No. 2 Hard Wheat, 92 score butter, or No. 1 potatoes are presumably the same regardless of when and where they are bought. All the consumer needs to do is to learn what these grades represent. Furthermore, standardization makes for a fairer method of price in a competitive market. Comparisons of quality are more easily made, and competition then becomes a matter of price and services. Finally, standardization, especially in manufactured goods, facilitates economy in production. It is easier to make goods of a single standard grade than to produce a great variety. In that connection the introduction of standard parts serves a useful purpose. Examples of this are standardized parts for light fixtures and, to a less degree, in connection with certain automobile parts. Connected with grading and standardization is the matter of labeling. Some kind of labeling or marking is essential in order to indicate a given grade. Often labeling may be used without any grading. In cases of no grade designations on the label, trial and error becomes the guide. Let us suppose that a certain kind of coffee is put out under the name of WYZ Coffee. We may not know the specific grade of coffee, but, if we like the coffee and the price, we have a guide for future purchases.

The number of grades in a given commodity should not be overdone. We could conceivably have an almost indefinite number of grades if we made sufficiently fine distinctions. Usually from three to six grades in the same commodity are adequate. Beyond this the cost of grading becomes excessive and serves no useful purpose.


HOW AMERICAN STANDARDS ARE DEVELOPED
SECTIONAL COMMITTEE METHOD
ASA
A GROUP OR COMPANY REQUESTS STANDARD
JOB AUTHORIZED BY COUNCIL
TECHNICAL COMMITTEE FORMED
members appointed by interested groups
SUB-COMMITTEES DRAFT STANDARD
SEND OUT FOR TRIAL AND CRITICISM
REDRAFT STANDARD
COMMITTEE VOTES FOR STANDARD
ASA COUNCIL APPROVES STANDARD
ASA
STANDARD PUBLISHED FOR USE

(Courtesy of American Standards Association.)

The consumer merely gets confused because of the great number of grades.

It would help to eliminate the confusion to the consumer if grade designations could be standardized. For example, the various qualities of beef are indicated as Prime, Choice, Good, Commercial, Utility, Cutter, and Canner; for potatoes, No. 1, 2, 3, etc., are used. If a simple understandable system such as A, B, C, D could be adopted, it would help to remove the existing confusion concerning the meaning of grade or quality designations.

	TYPICAL STANDARDS FOR CONSUMER GOODS			
STANDARDS OF	CANNED PEARS	DRESS PATTERNS	MILK	AUTO TIRES
SAFETY	YES	—	YES	—
QUANTITY OF MATERIAL	YES	—	—	YES
SIZE AND/OR FIT	YES	YES	—	YES
MEANING OF NAMES	YES	—	YES	—
RELATIVE USEFULNESS	YES	—	YES	YES

In view of the many advantages of standardization, why isn't everything standardized? There are many reasons. Part of it is plain inertia. It takes time for producers to decide to standardize certain unstandardized products. Again there are many products that do not lend themselves to standardization—there may just be no way of arriving at any sufficiently objective basis for grading. In addition to this some producers feel that they stand a better competitive chance in the market if no definite standards are set. Standardization and grading practically eliminate the opportunity of boosting the quality of one's own product over that of competitors.

Consumers have not concerned themselves too much about either greater standardization or more grade labeling. Wider use of quality grades on consumer goods would benefit consumers. To what extent more standardization is desirable is a debated issue. A completely standardized world might be economically sound, but it would be monotonous.

DIVIDING AND PACKAGING IMPORTANT FUNCTIONS

One important function of marketing is to provide goods in the precise quantities that we desire. This is what is meant by dividing. The most important thing is to get the desired goods, but this would be of little avail if it were necessary to take larger quantities than could be used at a given time. Many articles that leave the producers in carload lots are frequently distributed to the ultimate consumers in quantities costing only a few cents.

Closely related to dividing is the question of packaging. Should this function be performed by the original producer, by the middlemen, or by the final retailer? The tendency has been toward more and more packaging at the source of supply. Most of the remainder is done by middlemen before the goods reach the retailer. The day of the open sugar barrel and cracker case is pretty much a thing of the past.

Packaging at the point of production has several advantages. Since it can be done on a big scale, it is more economical than retail packaging, and the goods are better preserved; it facilitates standardization, provides for more accurate weights, and may make it more convenient for handling all along the line. In addition to this it makes it possible for the producer to put his own brand name on the package, although producers sometimes use several different brand names for the same commodity.

TRANSPORTATION A MAJOR ITEM

In normal times about 20 per cent of the national income is spent on some form of public or private transportation. Something like 15 per cent of the total national income is spent directly on the transportation of goods by private or public carriers. Nearly all this may be regarded as a part of marketing costs.

In spite of competition the railways still maintain an impressive lead as a medium of transportation. Water transportation is slow and is unavailable in most places. Although trucks have made rapid inroads into the business of the railways, the former are not adaptable to the transportation of very bulky products. Furthermore the railways have done much to provide services, like door-to-door delivery, which were formerly offered only by the trucking companies. Air transportation is still expensive, but the future potentiality of this form of transportation is tremendous. From the Second World War much has been learned concerning the possibilities of national and international air lines.

HOW TRANSPORTATION COSTS MAY BE REDUCED

From the viewpoint of an individual business the problem is to get adequate transportation at a minimum cost. Many elements are involved in this effort, a few of which will be discussed.

First of all is the question of distance from the supply. It is an easy matter to be overimpressed by low quotations and to forget about the added cost of transportation. The cost delivered to your place of business is the deciding factor, not the prices quoted at the point of shipment.

The next question is that of quantity purchases. Shipments in carload lots are much cheaper, but is a carload wanted? The money tied up, the cost of storage, the danger of deterioration or obsolescence must be considered. This problem ties up with the question of buying in small quantities from a near-by wholesaler or buying in larger quantities close to the source of production.

The medium of transportation is important. This may vary with the relative need for speed. The matter of service should not be ignored. There is finally the question as to the extent to which one should do his own transporting. Many concerns have their own trucks for the purpose of transporting at least a part of the goods to the store. Most businesses have their own delivery system for local trade. Some deliver to points 100 miles away or more.

The only generalization that can be made about transportation is that one should make a plan based on cost and convenience and follow this plan in all but exceptional cases. The wise planning of transportation policies may make the difference between a loss and a profit.

STORAGE IS ANOTHER BIG ITEM

Some supplies cannot be replenished more than once a year. This is true of most farm crops. Others require ageing. Some articles must remain on the shelves for a considerable time in order to provide adequate variety in slow-selling stock. Again certain things, for instance, books, can be produced economically only if a certain quantity is produced in one continuous process. Finally a certain amount of goods must always be on hand to obviate possible shortages.

Storage is not usually the function of any particular middleman but rather is spread along the whole line of the marketing chain. A considerable amount of storage is done in the homes of the ultimate consumers. Every household has a supply of certain things. Retailers exercise the storage functions to a considerable extent, and this is true even more of the wholesalers. Finally there is much storage on the part of producers. This is especially true of those engaged in seasonal production.

Some concerns make a business of storing. These enterprises are known as *public warehouses*. Anyone may arrange for storage in such a warehouse in return for which he gets a *warehouse receipt*. Frequently these receipts are made out to the bearer or the *order* of a designated party, thus making them negotiable. Negotiable warehouse receipts are a great convenience. The holder may sell his claim to the goods by selling the warehouse receipts. In other cases he may pledge it as a security for a loan. Frequently a person buys certain commodities, borrows the major portion of the cost, and deposits the warehouse receipt as security.

TRANSPORTATION AND STORAGE MAY BE MUTUALLY SUBSTITUTED

In many instances there is a choice between transportation and storage. In other words by doing more transporting it may be possible to reduce storage.

In a cold climate it is impossible to grow fruits and vegetables except at certain times of the year. In such a case the products may be stored for winter needs or it may be better to transport the goods as needed from other regions where they are produced. The determination of what to do depends on relative cost and the extent to which certain products may be satisfactorily preserved.

There is another way in which storage may save transportation expenses. Shipping goods in small lots is relatively expensive. This expense may be obviated by buying in carload lots and storing the goods till needed. Here again the businessman must do some careful figuring to determine which method will involve the lesser total cost.

Attention has frequently been directed to the cost of storage. It may be well at this point to consider just what such costs involve. The important expenses in connection with storage are as follows:

1. Possible shrinkage.
2. Other deterioration.
3. Risk of accidental destruction. This is usually covered by insurance.
4. Personal property tax, in most states.
5. Interest on investment.
6. Possibility of unfavorable changes in market value. Price changes may of course work in either direction.
7. The cost of space for storage.

The importance of each of the elements of storage cost varies with the nature of the commodity and the attendant circumstances. The cost of long-time storage is considerable and only under unusual circumstances is this a profitable practice.

RISK IS AN UNAVOIDABLE EXPENSE

Carrying on business invariably involves certain risks, and every prudent man must take this into consideration when he embarks upon a certain business. This potential risk should always be taken into consideration and treated as any other business expense.

Sometimes a person may protect himself against the potential risks by taking out insurance against specific possible losses. In this case he changes an uncertain risk into a definite periodic expense. In the long run this may cost more than shouldering the losses. Nevertheless insurance serves a highly useful purpose. The charge for each period is relatively small, and the insured is protected against possible losses that might be so huge as to ruin his business completely.

Some concerns embark upon a plan that is known as *carrying* one's own insurance. This is effected by gradually building up sufficient assets to take care of the loss as it occurs. This plan is feasible if the business has a great number of establishments in widely scattered areas, since it would then be unlikely that more than one of the many establishments would suffer a loss at one time. If there is only one establishment, the plan is not to be recommended. To be fully protected, a business would need to carry a vast amount of relatively idle funds while waiting for a loss that might never occur. Furthermore it should be remembered that the *insurance fund* must be built up gradually, and the loss might well occur before sufficient money was available to replace the destroyed assets.

Some risks cannot be insured against. Among these are losses resulting from general business failure, credit losses, and personal inefficiency. Certain risks peculiar to the marketing of goods include change in consumer demand, price changes, and competition.

Hedging is a common practice used in shifting risks from price changes. For instance a miller may on May 1 buy 1,000 bushels of wheat at $1.00 per bushel to be delivered in August. At the same time he contracts to sell in August 1,000 bushels of wheat at $1.00. If the price goes down between May and August, he will not lose as much as he would if he had not hedged. At the same time, if the price goes up he would gain less than if he had not hedged.

The only solution in these cases is to attempt to eliminate the causes and thus minimize the loss.

MARKETING INVOLVES MUCH FINANCING

The cost of financing the marketing process may be reduced in two general ways:

1. By economical use of funds
2. By keeping down the cost of acquiring current funds

The use of funds can be economized in a variety of ways. Perhaps the most important is to avoid carrying idle stock—in other words, to have a quick inventory turnover. Idle cash, heavy investment in superfluous fixed assets, and carrying an excessive amount in customers' accounts and notes are other instances of wasteful tying up of funds. Of course it is possible to go to extremes in either direction, but the foregoing are items that should be watched closely from the financial expense standpoint.

The amount of actual cash needed and the right proportion to tie up in receivables and inventories vary to such an extent with the nature and policies of the business that generalizations are difficult. Here are a few general suggestions:

1. Cash should constitute about 5 per cent of the total assets. Some of this might be invested temporarily in marketable securities.
2. The total of receivables from customers should not exceed the equivalent of the total credit sales for 60 days. In other words, if goods sold on credit in the average 60-day period amount to $20,000, the accounts receivables should not exceed $20,000.
3. The amount of inventory in proportion to goods sold should be in line with other successful stores selling the same line of goods. Reasonable information on these points can be obtained from books on marketing and retailing, and trade-association publications such as National Retail Dry Goods Association.

The cost of acquiring funds involves chiefly the question of interest and cash discounts. It sometimes pays to borrow from banks to tide over periods that make heavy demands upon cash. The alternative to this would be always to carry enough of a cash reserve to meet the high points. This would mean that at times there would be a considerable amount of idle cash on hand. A capable financier will borrow whenever it appears that he can save more than the amount of interest paid. Of course he is always careful to guard against imperiling the credit position of the business.

Does it pay to borrow to take a cash discount? Usually it does. If a merchant is offered a cash discount of 1 per cent when he must pay the bill in full in 30 days, he makes a return equivalent to at least 12 per cent annual interest on his money. He would therefore make a handsome profit by borrowing the money at 6 per cent. As a matter of fact, some concerns operate on such a close net profit margin that taking advantage of cash discounts constitutes a considerable part of their profits.

SUMMARY

Grading and standardizing are conducive to marketing economy and give the buyer greater assurance in that he knows just what he is buying. Grading and standardizing are, however, subject to certain limitations. Some things cannot well be standardized, and people's demand for variety sometimes discourages too much standardization.

Dividing and packaging usually go together. These functions are now frequently performed by the original producer. It is found that this is generally more economical and is conducive to a better preservation of the goods. In addition to this it facilitates the branding of certain goods.

Transportation and storage are highly important items in marketing. Sometimes storage may take the place of transportation and vice versa.

Risk is involved in all business transactions. Many of these risks may be guarded against by insurance. Insurance does not reduce the total risks for business as a whole, but it changes uncertain risks to certain and definite periodical payments. The most important function of insurance is to prevent a calamitous loss to any one person at any particular time.

Wise financing involves the economical use of funds and the acquiring of such funds at the lowest possible net cost. Thus it frequently pays to borrow money in order to take advantage of a cash discount.

QUESTIONS FOR REVIEW

1. What is the meaning of grading? Is it commonly needed?
2. What is meant by standardization? How may this be related to grading?
3. How do most factories standardize their products?
4. Explain how standardization is conducive to economy.
5. How is labeling related to grading?
6. Is it best to have many grades or only a few grades?
7. Since standardization has so many advantages, why isn't everything standardized?
8. In what way may dividing be considered a function of marketing?
9. Is packaging usually done by the middlemen? Does it make any difference who does the packaging?
10. Why may transportation be said to be a major item in marketing?
11. Explain three possible approaches to the task of decreasing the cost of transportation.
12. Is storage the function of any particular middleman? Does any middleman ever specialize on this function?
13. What is the purpose and use of a negotiable warehouse receipt? Mention its peculiar legal nature as a negotiable instrument.
14. Explain how transportation and storage may be mutually substituted.
15. Can any business be conducted without risk? Does the owner of the business necessarily have to bear the burden of assuming all the risk?
16. May all types of risk be transferred through insurance?
17. Explain the circumstances under which one may well carry his own insurance.
18. How may one proceed to cut down on financing costs through being economical in the use of funds?
19. How may one go about cutting financing costs of marketing through economizing in the cost of acquiring current funds?
20. What is the purpose of a cash discount?
21. Does it usually pay to borrow money in order to take advantage of a cash discount that is offered?

TERMS AND PHRASES TO DEFINE OR EXPLAIN

1. Grading
2. Dividing
3. Storage
4. Standardizing
5. Packaging
6. Risk-bearing
7. Labeling
8. Warehouse receipt
9. Financing marketing

QUESTIONS FOR DISCUSSION

1. "Most farm products may be graded, but they usually may not be otherwise standardized." Explain the meaning of this statement.
2. Since it usually will cost something to grade a product, how can it be more economical to have it graded than to have it ungraded?
3. Would a farmer get more for his entire apple crop if it is graded than he would if it were not graded? If the customer buys graded apples, does this mean he will get more or less for his money? Is it possible therefore that both the farmer and the customer profit from grading?
4. What objections would you see to returning to the old "cracker barrel" as a typical part of our marketing system? Would this likely mean that we could purchase our crackers more economically?
5. Does the standardization of a product through packaging and its tendency toward price-fixing as applied to that package mean greater or less competition on the market?
6. If clothing, houses, automobiles, etc., were standardized as to material, colors, design, etc., the cost to the customer could undoubtedly be lowered materially. To some extent we of course are doing this. What determines just how far we go, normally, in such standardization?
7. Can you think of any middlemen who do not perform the function of storage even to the slightest extent?
8. What types of risk are to be found in each of the following businesses:

   a. Farming
   b. Retail grocery store
   c. Retail clothing store
   d. A grain elevator in the Midwest
   e. A trucking company
   f. A wholesale fruit company

9. We know that very many businesses fail each year. Would we be correct in saying that each failure is due to failure to perform properly some function of that business?
10. Explain the relationship between a high rate of inventory turnover and lower cost of financing the marketing process.

CASE PROBLEMS

1. A certain canning company has for years prepared and sold peas of a relatively uniform size and quality under a certain trade name. The cans are identified only by this trade name and do not specify the size or quality of the peas used, but many customers have learned to know and to ask for this particular can of peas. This manufacturer objects when it is now suggested that he specify the size and grade of peas on each can. Do you think he should be required to do so?
2. John Andrews was a successful farmer. He objected, however, to paying the retailer a higher price for certain stock feeds than he found the wholesaler was charging for them, so he started buying in carload lots from the wholesaler and disposing of the surplus he could not use by selling it to other farmers at retail prices. Eventually he became interested in this new work and found it taking so much of his time that he could no longer successfully operate his farm. Therefore he sold the farm and started a stock-feed business in a near-by town. Five years later he found himself "broke." What were some of the causes that may have contributed to his failure?
3. The Custer Department Store purchases approximately $100,000 worth of merchandise annually and typically is offered terms of 2/10-n/60. The store practically never is able to secure the discount. At the same time it has excessively large accounts receivable, much of which represents accounts over 60 days old. Discuss the significance of this situation with respect to the expenses and the profits of this business.

SUGGESTED PROJECTS

1. Check through a current issue of *Printer's Ink* or some other magazine suggested by your instructor and make a list of packaging ideas you find that you consider somewhat unique or particularly interesting.

2. From a recent issue of *Nation's Business* select an article dealing with some marketing function or functions and report to the class the general nature of the information contained in it.
3. Find an article, book, or chapter dealing with the history and development of the business interests of some well-known American industrialist or businessman such as Ford, J. C. Penney, Wanamaker, Harriman, etc., and find illustrations of integration of functions therein.
4. Consult an encyclopedia, such as the "Encyclopaedia of Social Sciences," and present to the class other information about marketing or marketing functions that has not been presented in this chapter.

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16. Types of marketing units

PREVIEW: Several different kinds of markets are engaged in the process of marketing goods and services. Both industrial and consumer markets are involved. There are many different kinds of wholesalers and types of retail stores. What does industrial marketing include? What are some of the advantages and disadvantages of the different types of retail outlets?

MANY TYPES OF MARKETS

Wherever goods are bought and sold a market exists. Within the framework of this broad definition, there are many types of marketing outlets. The classification of these various markets may be on the basis of purpose, size, and manner of doing business. The second and third classifications will be applied to retail stores only.

In the classification given below it will be noted that there may be some overlapping, and it is not claimed that this is the only possible form of classification. The following arrangement will, however, serve to systematize our explanation and discussion:

CLASSIFICATION OF MARKETS

I. According to purpose
  A. Industrial markets
    1. Primary buyers
    2. Commission men
    3. Brokers and organized exchanges
    4. Cooperatives

- *B.* Consumer markets
    - 1. Wholesalers
    - 2. Retailers
- II. According to size
    - *A.* Large retail stores
        - 1. Department stores
        - 2. Mail-order houses
        - 3. Chain stores
    - *B.* Small stores
        - 1. General stores
        - 2. Specialized stores
- III. According to manner of doing business
    - *A.* Unit stores
    - *B.* Chain stores
    - *C.* Mail-order houses
- IV. Retail cooperatives (Chapter 18 deals with cooperatives)

We shall now proceed to consider these various markets somewhat in the order in which they are presented in the outline.

ALL MARKETS LEAD TO ULTIMATE CONSUMER

The end objective of all marketing efforts is to supply the needs of the ultimate consumer. However, the road that the product travels is not always the shortest distance between two points. Few products in our day are sold to the consumer in precisely the same form in which Mother Nature brought them into the world. Most goods must be *processed.* Processing itself may go through several stages before the goods are finally put into the channels of consumer trade.

On this basis, markets may be divided into industrial markets and consumer markets. Industrial marketing includes all selling and transporting steps that take place until the goods appear in their final form. At this point consumer marketing begins.

It will be noted that consumer marketing is not confined to retailing. It also includes middlemen operating between the final manufacturer and the retailer. For instance, when grain is sold to a cereal mill, industrial marketing stops. When the cereal mill sells the finished product to the wholesaler or other middlemen, consumer marketing has begun.

INDUSTRIAL MARKETING EXTENSIVE AND COMPLEX

For the sake of emphasis it should be repeated that consumer marketing begins when the goods start from the *final* producer toward the ultimate consumer. All the selling and buying that precedes this is industrial marketing. Sometimes this marketing is very direct; at other times the process may represent several steps before the goods are ready to be placed into consumer channels.

Iron ore, coal, pulpwood, and timber are examples of basic raw materials that usually pass directly from the producers to the processors. Farm products must generally be assembled from numerous small units, and this requires a more complex system. In this case local buyers usually purchase from the farmers. This is known as the *primary* market. The local buyers then sell to either the processors or some middlemen operating on a larger scale. The latter make up what are known as *central* or *terminal* markets. Terminal markets may be illustrated by places like the large grain elevators in Minneapolis and Duluth.

Persons who deal in industrial goods on a large scale may be either brokers or commission men. Brokers do not actually take over the goods under consideration but are merely instrumental in bringing the buyer and seller together. A commission man does not usually take title to the goods, but he does have temporary possession and carries on negotiations with the prospective buyer in much the same manner as he would if the goods were his own. When the goods are sold, he transfers ownership to the buyer, takes out his commission and expenses, and remits the balance to his client. Livestock, fruit, and vegetables are usually sold through commission men. Big-scale marketing of grain, cotton, and certain staple food products are largely negotiated through brokers.

Some people when considering marketing costs have in mind only the expenses and profits of concerns engaged in consumer marketing, such as wholesalers and retailers. Such a view of total marketing costs is inadequate. Although consumer marketing costs are generally greater than those for industrial marketing, in a few instances the reverse is the case.

Extent of Prewar Wholesale and Retail Trade in the United States
(1939)

	Number of employees	*Wages paid*	*Total sales*
Wholesale	1,562,121	$2,625,203,000	$55,265,640,000
Retail	4,600,117	4,529,499,000	42,041,790,000
Total	6,162,238	$7,154,702,000	$97,307,430,000

SOURCE: U.S. Bureau of Commerce.

Mass Production Requires Many Services in Getting Goods into the Hands of the Consumers. A Large Portion of Our Working Population Earns Its Living by Performing Specialized Wholesaling and Retailing Functions.

EXCHANGES FACILITATE TRADE

Exchanges are central marketing places created to facilitate trade among brokers. These may be either security exchanges or commodity exchanges. A good example of the former is the New York Stock Exchange. Such exchanges deal in stocks and bonds. Since we are not at present concerned about the discussion of dealings in stocks and bonds, nothing further will be said about this type of exchange at this time.

Commodity exchanges are frequently known as *boards of trade.* These deal largely in farm products, and the largest ones are found in Chicago, New York, Minneapolis, and Kansas City. The business on these exchanges is carried on by brokers who purchase *seats* on the exchange for their convenience.

Commodities on these exchanges are sold for either immediate delivery or future delivery. Transactions of the former type are called *spot* or *cash* sales; the latter are designated as *future* dealings. For instance, if in April a person buys 10,000 bushels of September wheat, it means that he contracts to accept this amount of wheat in

September. Most, although not all, of the future trading is of a speculative nature, *i.e.,* the buyer hopes to sell his contract at a profit before the time for delivery arrives. Except for millers and exporters, the buyer seldom plans actually to call for the wheat.

THERE MAY BE MANY STEPS BETWEEN PRODUCER AND RETAILER

When goods assume their final form in which they are to be sold to customers, they are directed toward their final destination in a manner which to each dealer appears to be the most economical. There is no uniform method in this process. Some goods are sold direct to the retailers; some are subjected to only one intermediate transaction; others again may pass through several hands before they reach the retailers' shelves. Automobiles, refrigerators, and, in general, all articles selling at a high unit price are sold by manufacturers directly to dealers. Drugs, food products, small hardware items, etc., may require more than one intermediate dealer.

THERE ARE MANY KINDS OF WHOLESALERS

The word *wholesaler* may be construed in a restricted sense to refer only to middlemen who sell to retailers. In a broader sense it may include any middlemen operating between producer of the finished product and the retailer. Again wholesalers serving in somewhat similar capacities may carry on their work in different ways. Based on this explanation we may mention the following types of wholesalers:

1. *Mill agents and sales agents.* Persons who serve particular producers, usually in specified areas. Sales are usually made on a commission basis.
2. *Commission houses.* Somewhat similar to mill agents except that they usually undertake to sell the whole output of one or more producers.
3. *Wholesale merchants.* These are wholesalers in the restricted sense. They buy goods on their own account and sell to retailers or *specialized* wholesalers, depending upon the variety of goods carried.
4. *Jobber.* Originally this meant any person who bought odd lots

or "jobs" to sell to retailers. Such jobbers could be either general or specialized. The distinction between a jobber and a wholesale merchant has now practically disappeared, and the words are frequently used interchangeably.

SIZE OF BUSINESS IMPORTANT IN RETAILING

Regardless of other distinguishing features, the matter of size is an important consideration in connection with a retail outlet. Certain economies may be effected by reason of the large size of the enterprise. On the other hand, smaller stores may also have certain advantages over the large concerns.

Perhaps the greatest advantage of a large retailing business is the possibility of purchasing in large quantities. Frequently such a business may buy the whole output of certain producers. Quantity discounts may be secured, and transportation costs may be reduced by buying carload lots. Other advantages of a large business are the possibilities of functional specialization, standardization of methods, a more complete line of goods, and possibly a quicker turnover of inventories.

Although the small stores may lack some of the advantages of the larger concerns, there are certain compensating factors. Direct and detailed supervision by the owner, greater flexibility, less expensive methods of supervision and control, and closer personal relationship with customers are advantages that sometimes largely offset the disadvantages inherent in a small business. If conducted in an efficient manner, a small store has a good competitive chance of making a success of its business.

SMALL STORES MAY BE EITHER GENERAL OR SPECIALIZED

A general store, as the name indicates, is one aiming to carry several lines of general merchandise. Such stores are commonly found in rural communities. There is no fixed limit to the number of items offered for sale by these stores, but they generally handle food, work clothes, low-priced dresses, household appliances, small hardware, and paint. There was a time when the general store was practically the only source of supply for some communities. With the advent of the mail-order houses and the coming of the automobile, the general store has become somewhat more restricted in its possibilities. However, the low cost of operation, avoidance of congestion, and proximity to customers still give these stores a good chance of survival. The general store to be successful must study carefully local needs and confine the business to items for which there is a steady and adequate demand.

Small specialized independent stores are common both in small towns and in large cities. The chief stores of this kind are those selling food, drug items, women's clothing, men's clothing, millinery, tobacco, furniture, and hardware. These stores are sometimes called *specialty stores.* Examples of these are radio shops and stores confining their business to household electric appliances.

CERTAIN TYPES OF RETAIL OUTLETS ARE LARGE

There are some retail outlets that cannot operate successfully except on a large scale. Certain advantages and disadvantages resulting from size are common to all such concerns, and these factors were discussed in the previous section. The retail outlets that are commonly large are the following:

1. Department stores
2. Mail-order houses
3. Chain stores

Each of these types of business has certain peculiarities, which will now be briefly discussed.

DEPARTMENT STORES A COMBINATION OF STORES

A department store is essentially a combination of stores under one roof. For instance, the women's clothing department, the shoe department, the furniture department, the grocery department, and the dry-goods department are in different parts of the building and are operated very much as separate stores. However, there is one general management, and the functions of credit, collections, financing, accounting, etc., are carried on for the store as a whole. There may be any number of selling departments in addition to service departments.

Department stores are not especially economical to operate. They do have the advantages incidental to size, but the expenses for rent, services, collections, bookkeeping, etc., are usually high. A department store derives its popularity largely from shopping convenience, free services, variety of selection, and high merchandising standards. Most department stores feature service rather than price.

MAIL-ORDER HOUSES ARE STILL POPULAR

Mail-order houses became prominent about sixty years ago and received their chief original impetus from the need of supplying rural communities with a wide variety of goods at a low price. With the coming of the automobile this need was partly lessened, but mail-order houses are still holding their own. Relatively low prices, liberal return privileges, fast and dependable service, wide selection of merchandise, and the convenience of shopping without leaving one's own home are some of the customer advantages claimed by mail-order houses. Some serious disadvantages are impossibility of seeing the goods that are bought, inability to get immediate delivery, and unavoidable delays when adjustments are to be made.

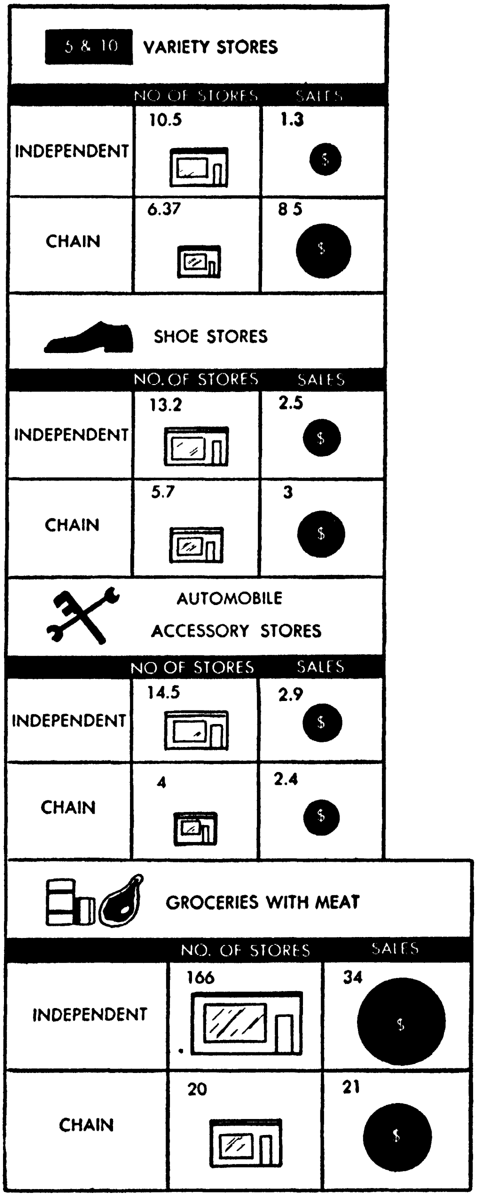
The mail-order house maintains the advantages that accrue to any large-scale business. It is also probably cheaper to pack goods from an order sheet than to wait on personal customers. On the other hand, mail-order houses have a tremendous advertising expense and spend more than the average retailer in making necessary adjustments with the customers. Furthermore the transportation cost is considerable on small packages.

CHAIN STORES HAVE MADE GREAT PROGRESS

A chain-store system consists of a number of stores operating in various localities under one general management. By this method it is possible to operate a huge merchandising business and yet retain some of the advantages enjoyed by the smaller stores. It is not to be wondered at that the chain-store business, which fifty years ago was insignificant, now embraces close to 25 per cent of the total retailing in this country. Chain stores are much more common in some fields than in others. They have been especially successful in certain lines. The chain variety stores control 90 per cent of the 5- and 10-cent-store business; automobile-accessory stores, shoe stores, and grocery-with-meat markets have also been especially successful.

Chain stores are *not expanding* as rapidly now as they did up to about ten years ago. This is due to several reasons, among which are the following:

1. The progress of chain stores was so rapid that the number of such stores may have temporarily reached the saturation point.
2. Most chain stores operate on a cash-and-carry basis and do not appeal to people who demand a considerable amount of service.
3. Chain stores stress *low prices.*
4. There are open and vigorous hostilities by independent dealers, sometimes accompanied by legislation aiming to place chain stores at a relative disadvantage.
5. Independent dealers prodded by chain-store competition have improved their merchandising methods.



CHAIN STORE ACTIVITY IN CERTAIN FIELDS. (Figures are in thousands.) (Data taken from Statistical Abstract of the United States, 1943.)

There is no question that chain stores are here to stay. Most of the accusations against them are unfounded. The extent to which they will expand depends upon their ability to prove that they have certain customer advantages over competing types of stores. In 1943, chain stores and mail-order houses accounted for approximately 25 per cent of all retail sales for a record total of $14,500,000,000. This is $113 per capita. However, this was a gain of but 3 per cent over 1942, whereas independent stores showed a gain of 10 per cent during the same period.

PLACE FOR VARIETY OF STORES

It might seem that one type of retail store might become so decisively superior in efficiency that all other types would disappear. This does not appear to be the case. In the *U.S. Retail Trade Census of 1939* it was shown that nearly 60 per cent of the retail business in this country was carried on by concerns having annual sales of $100,000 or less. Less than one-fourth was handled by stores having sales above $300,000. This indicates that the relatively small store maintains an important place in the total retail business.

There may be several reasons why a variety of competing types may continue to operate side by side. In the first place the net advantage of one over the other is not very great; furthermore the success of one type spurs the other on to greater efforts; finally we must remember that people have varied tastes and attitudes. Some people are concerned chiefly about price; others want to be sure of dependable quality. Many people want convenience and service above all things; a few like to buy in exclusive shops even if the prices are admittedly higher.

There is a great variety of retail outlets in this country, and they are probably all here to stay for some time to come.

Retailers Classified by Kinds of Business with Number of Stores of Each Kind During Normal or Prewar Times (1939)

Kind of Business	*Number of Stores*
Combination grocery and meat stores	187,034
Motor vehicle dealers (new)	33,609
Department stores	4,074
Filling stations	241,858
Grocery stores (without fresh meats)	200,303
Restaurants, other eating places	169,792
Drugstores	57,903
Lumber, building-materials dealers	25,067

Fuel, ice, fuel-oil dealers	41,172
Women's ready-to-wear stores	25,820
Variety stores	16,946
Furniture stores	19,902
Men's and boys' clothing, furnishings, hat stores	21,501
Dairy products, milk dealers	16,834
Hardware stores	29,147
Hay, grain, and feed stores	16,772
Shoe stores (all kinds)	20,487
Liquor stores (packaged goods)	19,136
Accessory, tire, battery dealers	18,525
Family clothing stores	10,053
Jewelry stores	14,559
Household-appliance dealers	11,095
Candy, nut, confectionery stores	48,015
Cigar stores, cigar stands	18,504
Radio-household-appliance dealers	6,907
Farm- and garden-supply stores	4,915
Paint, glass, wallpaper stores	8,480
Florists	16,055
News dealers	7,407
Radio stores other than radio-household-appliance dealers	2,911
All other kinds of business	455,572
Total	1,770,355

SOURCE: Sixteenth Census, Census of Business, 1939.

SUMMARY

Industrial marketing includes all the marketing steps that are necessary before the goods to be produced assume their final form. Consumer markets relate to the passing of the goods from the final producer to the ultimate consumer. Some goods are sold directly by producer to consumer; some directly to retailers. Most of the goods pass through at least one other middleman before reaching the retailer. These middlemen may be broadly referred to as *wholesalers.*

The retail outlets represent an interesting variety. There are large retail stores and small retail stores. Some feature low prices; others stress quality, convenience, and service. Some are local; others operate on a regional or national scale.

The chief types of stores are department stores, mail-order houses, chain stores, general stores, and specialized stores. Under efficient management any of these kinds of stores may operate successfully in competition with the other types.

QUESTIONS FOR REVIEW

1. Indicate a classification of markets according to purposes.
2. When classified according to size, what types of retail stores fall under each classification?
3. How may markets be classified according to manner of doing business?
4. Distinguish between industrial markets and consumer's markets.
5. What may consumer's markets include besides retailing establishments?
6. In industrial marketing, what is meant by a primary market? Is this present in all types of industrial marketing?
7. What is meant by a central or terminal market?
8. Define and differentiate between brokers and commission men.
9. What is meant by a board of trade? Is this the same as a security exchange?
10. What is meant by a spot or cash sale? What is the other type of dealing called?
11. Which type of trading is largely of a speculative nature? Does the operator on the futures market ever expect to take actual possession of the commodity purchased?
12. What determines the route (or steps) taken by commodities in passing from the producer to the consumer?
13. Identify several of the various types of wholesalers.
14. Point out the advantages and disadvantages of size in retail establishments.
15. Discuss the relative present-day opportunity of the general store.
16. What is meant by a specialty store? Where is it found? What are its advantages?
17. What types of retail outlets are typically large?
18. In what way may a department store be said to be a combination of stores?
19. What advantages and disadvantages attach to a department store?
20. Why did mail-order houses ever become popular? What disadvantages do they possess?
21. In what ways may the economies of mail-order selling be questioned?
22. What are some of the reasons why the expansion of chain stores has decreased?
23. What indication can you mention that points to a probable continuation of a variety of types of retail stores?

TERMS AND PHRASES TO DEFINE OR EXPLAIN

1. Wholesalers
2. Jobber
3. Retailers
4. Brokers
5. Spot sales
6. Speculator
7. Exchanges
8. Cash sales
9. Industrial markets
10. Terminal markets
11. Department stores
12. Specialized stores
13. Board of trade
14. Future dealings
15. Chain stores
16. Mill agent
17. Primary markets
18. Consumers' markets
19. Commission men
20. Mail-order houses
21. Specialty stores
22. Independent dealer
23. General stores

QUESTIONS FOR DISCUSSION

1. In which type of marketing do you feel that the purchaser is more likely to demand extra services, the industrial or the consumer type?
2. Marketing functions have sometimes been divided between assembling and disbursing (or selling). What are illustrations of markets dealing quite largely with one or the other of these two areas of functions?
3. Since brokers do not have ownership of or possession of the actual goods, do they perform any real marketing function?
4. Most futures dealings are speculative. This being the case, do they perform any real marketing function? Would you conclude that such speculative transactions are socially desirable?
5. A seat on an exchange frequently sells for thousands of dollars. Why would a broker be willing to pay such a seemingly high price for the privilege of doing business on the exchange?
6. What marketing function would you say a mill agent performs?
7. Do you think it is a good thing for a given city to have chain stores located in it?
8. Department stores sometimes are criticized for offering so many free services. Do you feel that such stores could afford to sell their goods at lower prices if they dispensed with such services?

CASE PROBLEMS

1. On September 1, Cornelius Winstrop contracted on the futures market to buy 10,000 bushels of wheat to be delivered in Decem-

ber. On October 15 he then sold the same amount of wheat, agreeing to deliver it in December (*i.e.,* he sold December wheat). He made a profit of $500 on the two contracts. He of course never did expect actually to receive or use the wheat and was merely speculating. Has he performed any service to society through this deal? Might he have lost money on it? Had he lost money, would your answer to the first point be the same?

2. On September 1, the Pilgrim Flour Company purchased 10,000 bushels of wheat on the spot market and had it shipped to its mill. On that same date, however, the company contracted on the futures market to deliver the same quantity of wheat in December. (This is known as *selling short.*) On November 1 the company disposed of the flour that it had manufactured from the wheat purchased September 1; and on the same day it contracted to buy on the futures market 10,000 bushels of wheat for December delivery. (This purchase was to "cover" the former short sale.) When asked why he had placed these two contracts in the futures market, the manager of the company stated that he was merely hedging to avoid any speculative loss due to a possible drop in the price of wheat before he could get his flour sold. Can you explain how these transactions in a speculative market could result in avoidance of possible speculative loss?
3. During an inflationary period a number of married students at a large university decide to organize a cooperative in an attempt to reduce the cost of their living expenses. They plan to buy staple items, mostly groceries, and believe they should get them at a lower cost this way. Prepare a list or outline of some of the problems involved that they should not overlook before finally deciding whether to go ahead with the project.
4. For fifty years Bill Hagge has operated the general-merchandise store in the village of Beamer, Iowa. He has been definitely successful during all this period. About 1920 Beamer had secured a consolidated school which kept trade coming into the village. However, in 1946 this school was closed, and the district consolidated with that of a larger near-by town. Mr. Hagge still has a large investment in inventory but doubts whether his good business will continue. He can sell out only at a huge loss. What would you advise him to do?

SUGGESTED PROJECTS

1. Find out what is meant by "selling short" and "selling long."
2. Find out what is meant by quoting prices as a certain number of points "on" or "off" the futures market. On what type of market is this used?
3. Read a description of an actual commodity exchange in operation and explain some of its interesting points to the class.
4. Find an illustration of hedging to avoid speculative loss due to fluctuation in prices, and explain to the class how it worked.

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17. Sale of services

PREVIEW: Marketing involves more than the sale of commodities. Approximately one-half of those engaged in marketing are concerned with the selling of services. The techniques used in selling services are somewhat different from those used in marketing commodities. What are some of the activities that are classed as services? What techniques are used to sell services?

SALES NOT CONFINED TO COMMODITIES

Many people when they speak about sales have in mind primarily the sale of concrete objects such as food, clothing, fuel, lumber, and automobiles. This is an inadequate conception of what marketing involves. As a matter of fact the sale of services is about equal in importance to the sale of commodities.

A little reflection will reveal how important the sale of service really is. Every employee, whatever his work may be, is a seller of services. The same is true of any person who rents out the use of property or who furnishes money or credit in return for interest. In addition to this we have transportation, communication, medical services, entertainment, education, and numerous other forms of benefits involving little or no transfer of concrete goods. The rendering of all such services for remuneration may be classed as the sale of services.

Sometimes the sale may be one of service alone. At other times there may be a combination of services and commodities. Even when the sale is primarily one of commodities, some service frequently accompanies the sale. On the other hand there are cases in which the sale is chiefly one of services coupled with at least a small amount of commodities.

In a majority of the sales of commodities a certain amount of service is usually included. Examples of this are the granting of credit, free delivery, and an agreement to give repair services on the article sold for a stated length of time. The work of a housemaid, advice by a lawyer, and repair work involving no materials are examples of pure service. Transportation, the furnishing of electricity, and repair jobs involving material include the consumption of a certain amount of commodities, but these are nevertheless classed as services. A sale should be classed as a service sale whenever the primary objective is to render a service rather than to transfer commodities.

THE VOLUME OF SERVICE SALES

It has been mentioned that the sale of services is about equal to the sale of commodities. Stastistics compiled by the National Resources Committee indicate that, in 1935, 42 per cent of the workers of the country were employed in what was called the *service industries,* and since that time there are good reasons to believe that the proportion engaged in services has been increasing. Furthermore the Committee's definition of "services" is narrower than that employed by many writers, since it excludes transportation, communication, and electric power. When these areas are included, well over half of the employed are in the service industries.

The types of activities that may be included under services are numerous, but most of them would be covered by the following headings:

1. Personal servants—house servants, barbers, hairdressers, launderers
2. Repair services of all kinds
3. Advice and information—lawyers, architects, physicians, engineers, etc.
4. Entertainments—theaters, races, resorts, beaches
5. Lodging—apartments, hotels, rooming houses
6. Transportation of all kinds

7. Communication—telephone, telegraph, radio, postal department
8. Light and power
9. Protection—various kinds of insurance
10. Investment service
11. Government services of all kinds
12. Education—teachers and administrators

During the Second World War about one-half of our total national resources were devoted to the war. Since the war was fought to protect this country, its ideals, and its interests, this whole huge outlay might be classed as services. Since most of the normal services also continued, it is safe to say that, during the war, services outweighed commodities by something like a 2-to-1 ratio.

PRODUCERS' SERVICES AND CONSUMERS' SERVICES

A distinction should be made between *producers'* services and *consumers'* services. Producers' services are those rendered for the production of commodities or services to be sold. Consumers' services are those placed directly at the disposal of the ultimate user. A few illustrations will serve to clarify these definitions.

Most people who work as employees are engaged in producers' services—in fact this is also true of most of the employers. Among others who may be definitely classed as providing producers' services are those who lend money to a business, rent out store buildings and offices, or who provide heat, light, and power to manufacturers.

Examples of consumers' services are household service, passenger service, amusements and entertainment, education, religious services and medical advice. It will be noted that these services are always or nearly always rendered as a service to the final consumers.

In most cases the distinction between producers' service and consumers' service does not lie in the nature of the activity but rather in its application. For instance, if a person sweeps floors in a factory, he is providing producers' service; if he sweeps floors in your home, he is engaged in consumers' service. Such important items as transportation, communication, power, and financial services are either producers' services or consumers' services, depending upon the status of the person using the services. There are a few services that, by their nature, are distinctly one or the other, but these are the exceptions and not the rule.

SERVICES MAY BE PERSONAL OR COMPOSITE

A further classification of services may be of *personal* services and *composite* services. A personal service is one that is rendered by one person directly to another person. Examples of personal services are housework, legal and medical advice, and hairdressing. Other services are the results of several factors working together. For instance, the transportation of passengers involves construction and maintenance of railways, the providing of coaches, the services of a variety of employees, and numerous other contributing factors. In some cases of what may be called *composite* services, the use of commodities may be such an important element that it becomes difficult to decide whether the transaction should be classed as a sale of services or a sale of goods. Once more we should be mindful of the fact that most sales of commodities are partially sales of services.

MOST SERVICE SALES MADE DIRECTLY

The question of middlemen does not enter prominently into the sale of services. In most cases the person who renders the service is also the seller of that service. When we employ a person for work, buy a ticket to a theater, purchase a postage stamp, or travel on railroads and buses we usually deal directly without the intervention of middlemen.

However, we should not assume that middlemen are completely eliminated in connection with the sale of services. Houses and apartments are frequently rented through agents. Steamship tickets and travel tours are often bought from persons acting as agents for the companies. Theater tickets are handled by certain stores and hotels. Stocks and bonds are commonly sold through brokers. A person's individual services are sometimes sold through public or private employment agencies. Entertainers are often represented by agents. In cases where services are sold through another, it is seldom that there is more than one middleman. Wholesaling is practically unknown in the marketing of services.

THE ADVERTISING OF SERVICES

Only a small portion of total services sold is through middlemen. Advertising is commonly employed. In the advertising of services the same types of appeal are used as in the sale of goods. It is necessary first to determine which human desires are to be satisfied. Then in a convincing manner it is shown how a particular service will satisfactorily supply the need. The various kinds of service enterprises have different types of advertising, and a few of these will be considered.

Motion pictures. Few, if any, types of service are advertised more extensively and vigorously than motion pictures. This is carried on from the producers down to the local theater in the smallest hamlets. Perhaps the most effective advertising is through previews presented by the producers themselves. Other effective advertising is handled by means of billboards and newspaper advertising. The radio is beginning to be used more and more as a direct or indirect advertising medium for the movies. Special attractions such as "give-aways," bingo, and bank nights are employed by many theaters to attract the crowds. Heavy and constant patronage is especially important for an industry like the movies, since it costs but little more to show a set of film to a full house than it would cost to run through the picture for a dozen people.

Hotel service. Hotels are primarily purveyors of rest and comfort. In addition to this they may stress courtesy, congenial surroundings, food, entertainment, and nearness to shopping, entertainment, and business facilities.

Most hotels are not heavy advertisers. Much of the advertising is on billboards along the highways, in railway guides and similar publications, and, to some extent, in newspapers. Some hotels in the large cities advertise on a national scale. On the whole, hotels rely chiefly upon building up a clientele through persons who will put in some good words for the hotel when talking with their friends. A hotel must decide upon the class of people to which it wants to cater. Some hotels stress the idea of comfortable accommodations at low cost; others go to the other extreme of making themselves exclusive by charging higher rates than most people can afford.

Professional service. In the legal, medical, and accounting professions, and in some others, advertising in the ordinary sense of the word is considered unethical. Such newspaper advertising as is carried on usually consists of a brief announcement concerning name, place, office hours, and the type of services. However, much sales promotion may be carried on in indirect manners. For example, lawyers may advertise themselves by joining organizations, holding public offices, and making speeches. When the reputation of such professionals as lawyers, doctors, and public accountants is once established they can safely rely upon a continued patronage without much publicity effort on their part.

Public utilities, railroads, and insurance companies carry on advertising through all advertising media available. Much of this advertising is devoted to efforts to increase the general use of the particular service offered. For instance, a life-insurance company will stress the need of life insurance. When this point is made, this particular company will then point out the advantage offered by the policies it is issuing.

OPPORTUNITIES IN THE SERVICE FIELD

A young person who plans to enter into business for himself may well look into the opportunities offered in the great variety of service occupations for which he may prepare himself. It is found that as the standard of living increases people will buy proportionately more services as compared with commodities. One great advantage in the service field is that it usually requires a relatively small amount of invested capital. If you are well prepared, have the right personality, furnish a service that people want, and choose a good location that is not already overcrowded, a reasonable degree of success should be assured.

SUMMARY

Marketing is not confined to the sale of concrete and tangible objects. The selling of services is almost as important and extensive as the selling of goods, and the former is continually increasing. Outstanding examples of services are domestic service, transportation, communication, education, entertainment, and government services.

Services may be either producers' services or consumers' services. The former refers to services employed in producing something; consumers' services are those which are rendered directly to the final user. Most services may be either producers' services or consumers' services, depending upon the nature of the use rather than upon the kind of service.

Services are usually sold directly by the person rendering the service, although they are sometimes sold through middlemen. Except in the case of a few professionals, such as physicians, lawyers, and public accountants, advertising is more or less extensively used in promoting the sale of services.

QUESTIONS FOR REVIEW

1. Give illustrations of services for sale in the area of marketing.
2. Is the sale of service ever combined with the sale of commodities?
3. To what extent are workers employed in the service industries?
4. Give illustrations of producers' services; of consumers' services.
5. Distinguish between personal services and composite services.
6. Are middlemen employed in the sale of services?
7. Give illustrations of the use of advertising in the sale of services.
8. In what ways is the sale of professional service "advertised?"
9. As our standard of living improves, may we expect a relatively larger or smaller sale of services in comparison with sale of commodities?
10. What advantage does the business of selling service frequently hold as compared with the business of selling commodities?

TERMS AND PHRASES TO DEFINE OR EXPLAIN

1. Producers' services
2. Personal services
3. Investment service
4. Informational services
5. Consumers' services
6. Composite services
7. Protection service
8. Entertainment service

QUESTIONS FOR DISCUSSION

1. Which do you think would require better salesmanship, the sale of a service such as entertainment or the sale of a commodity such as clothing?

2. Which of the following would you say are engaged essentially in the sale of service?

A college professor
A barber
A shoe-repair operator
A cleaning and pressing establishment
A tailor
A daily newspaper
A minister
A painter
An insurance company
An architect
An attorney
A beautician
A laundry
A veterinarian
A chiropractor
A bowling alley
A taxi company
A construction company
An abstract company
A city streetcar company
A dentist

3. To what extent does the sale of related or accompanying services result in an increase in the total sales of commodities of various types? Substantiate your opinion by illustrations.
4. Which is likely to require a larger investment, a business engaged primarily in the sale of commodities or one engaged primarily in the sale of services? May there be exceptions to your answer?

CASE PROBLEMS

1. In due time after the cessation of hostilities in the fall of 1945, Phil Doran received his honorable discharge from the U.S. Navy. Previous to entering the Navy he had been a laborer doing unskilled work in a meat-packing plant. He had only a high-school education. While in the Navy he had received special training in radio and had served as a radio technician. He understands radio construction and operation thoroughly and has decided that he should make use of this knowledge and ability now by operating a radio repair service. At the same time, he realizes that he has had no training or experience in the operation of a retail business and that he would run the risk of failure and loss of investment. He is undecided as to what to do about it and asks for your advice. What are some of the pertinent points that you might discuss with him in an effort to help him make a wise decision?
2. Ray Rice is a senior commerce student at a large university enrolling several thousand war veterans. He observes the limited laundry facilities available for family use and is thinking of starting a diaper laundry service. He has $10,000 capital and plans to use automatic

machines that would require but little help. What are some of the problems which he would have to solve?

3. In the preceding case, in what way would his problems differ if he were to decide to open a university taxi service?

SUGGESTED PROJECTS

1. Turn to the classified section of your local telephone directory and make an analysis of at least twenty business classifications you find there. Attempt to divide them into two groups, those businesses primarily engaged in the sale of service and those primarily engaged in the sale of commodities.
2. Examine a current copy of your local paper and make a list of all the advertisements appearing therein representing businesses and professional people primarily concerned with the sale of services.
3. Prepare a list of service occupations for which graduates of collegiate schools of business may well be prepared.

REFERENCE

SWAYZEE, C. O., and C. M. HICKS: "An Introduction to Business," Chap. XXVIII.

18. Marketing and consumer cooperatives

PREVIEW: Marketing is usually carried on for private profit, and so far in our discussion it has been assumed that profit is the chief motivating factor. In some foreign countries, and to a less extent in this country, cooperative marketing and cooperative buying by consumers is employed. The basic idea in cooperatives is that the business is owned by the patrons and is carried on primarily for the benefit of the patrons. What are the basic principles upon which cooperatives operate? What are some of the factors responsible for the origin of cooperative marketing? What are some of the reasons cooperatives are not more successful in the United States?

THE BASIC PRINCIPLE OF COOPERATIVES

In this book we frequently refer to the advantages and disadvantages of competitive business carried on for the benefit of the owners. Those who favor the cooperative organizations maintain that, at least in some business activities, the social good is better served by cooperation than by competition.

Business competition is admittedly motivated by individual self-interest. Those who defend this system nevertheless maintain that competition results in the public good, because good and honest service is the surest way of getting patronage and, hence, profits. Cooperation approaches the quest for the public good in a more direct way by making the welfare of its *patron-members* its direct and basic objective.

It cannot be denied that there is something to be said in favor of the argument for cooperation. Since the good of the patrons is presumably the sole objective, there should be no temptation to impose upon them by means of misrepresentation, exaggerated claims, and inferior goods. Insofar as the members are concerned, unreasonable prices are eliminated by redistributing profits to the members in proportion to business done.

The principles that have been so effective in the operation of cooperatives were established over a hundred years ago. Here are the basic principles and methods of cooperatives:

1. Unlimited membership—open to all
2. Democratic control—one vote to a member with no voting by proxy
3. Fixed interest on capital—return on investment at prevailing rate of interest
4. Savings or surplus distributed to members—profits distributed on basis of patronage
5. Education carried on—members constantly taught the principles of cooperatives
6. Business on a cash basis
7. Cooperative associations shall maintain political and religious neutrality.

WHAT IS MEANT BY COOPERATIVE MARKETING

Cooperative marketing consists of the control and operation of marketing activities for the benefit of persons who are both patrons and members of a voluntary marketing association. Such an organization may be either a buyers' cooperative or a sellers' cooperative.

Perhaps the outstanding point in the definition is that the members of the association are at the same time the chief, if not the only, patrons of the association. Benefits and advantages redound to the members as *patrons* rather than as members. In fact in a truly cooperative association the members can receive substantial benefits only to the extent that they are patrons of the association.

The only common exception to this rule is that they may receive a fixed interest return on their investments in the association.

WHY COOPERATIVE MARKETING

Often the individual seller of farm products is the victim of circumstances beyond his control. A large group of farmers acting independently is usually forced, because of a lack of cash and storage space, to dump their products on the market at the same time. This practice results in an excess of the immediate needs of the market and tends to reduce prices below that which might be obtained if more orderly marketing was effected. Individual bargaining power of one small farmer is not very effective.

By joining together into a marketing cooperative, farmers derive certain advantages, for example,

1. Strengthened bargaining power
2. Opportunity to secure financing, essential to modern marketing
3. Help of skilled marketers
4. Opportunity for orderly marketing instead of the dumping of farm products on the market
5. Economies in marketing through lower freight costs, higher standards of quality through group grading and education, and storage facilities

Marketing cooperatives aim at getting a greater return on the products sold. This is supposed to be brought about chiefly through cooperative demand creation, orderly marketing, and savings in marketing costs. It is generally claimed by producers that this will not necessarily mean higher prices to consumers. In fact it is frequently claimed that the savings effected through cooperation are great enough to allow lower prices to consumers and yet give a better net return to the producer. Here again the question becomes one of the relative efficiency of cooperation and competition.

CONSUMER COOPERATIVES

Cooperative associations may be created either for the benefit of buyers or for sellers. The former are consumers' cooperatives; the latter, producers' and marketing cooperatives. The general principles are the same in both cases, but there is some difference in the specific objectives and the manner in which the cooperative principles are carried into effect.

In a consumers' cooperative the basic purpose is to provide the members with a greater quantity and quality of goods and services for the money expended. In other words it is the aim to make possible a more satisfactory and economical method of purchasing. The issue then becomes whether or not people's needs can be more effectively supplied through cooperation than through the usual competitive business channels. Some consumers support cooperatives because they believe they are a sound means of attaining a more equitable and democratic economic system.

Today the consumers' cooperatives in America are doing a 600 million dollar business. It is estimated that there are approximately 2 million members of consumers' cooperatives.

LIMIT TO POSSIBLE ADVANTAGES

Some of the enthusiasts for cooperation start out with exaggerated expectation and hence become subject to painful disillusion. Cooperatives have possibilities, but there is a limit to what they can accomplish, and they are not necessarily, in themselves, the solution to all our economic ills. For instance, some people seem to think that if they join a consumer cooperative, they will "get everything wholesale." They become badly disappointed when they discover that the best they can do is to save 4 or 5 cents on the dollar.

The reason why the saving must be relatively small should be obvious. A cooperative association, the same as a private competitive enterprise, has expenses. There must be payments for rent, salaries, supplies, etc., and all this must be added to the price at which the goods are sold. Cooperation may eliminate middleman as such, but it does not do away with the middleman's functions. The execution of these functions costs money whether carried out by a cooperative association or by profit-seeking middlemen.

How, then, can a consumers' cooperative hope to save its patrons anything? If efficiently conducted, such an organization may save the consumers something for the following reasons:

1. Net profits, if any, are distributed to the patrons. In a private enterprise it would be kept by the proprietor.
2. Less money needs to be spent on advertising and other sales efforts, since a group of loyal members assures adequate patronage.
3. Since the direct aim of the association is to provide advantageous buying opportunities for its members, there should be little temptation to take advantage of the customer. Unfortunately such a practice may obtain in a private business conducted purely for the profit of the proprietor.

HAVE COOPERATIVES BEEN SUCCESSFUL?

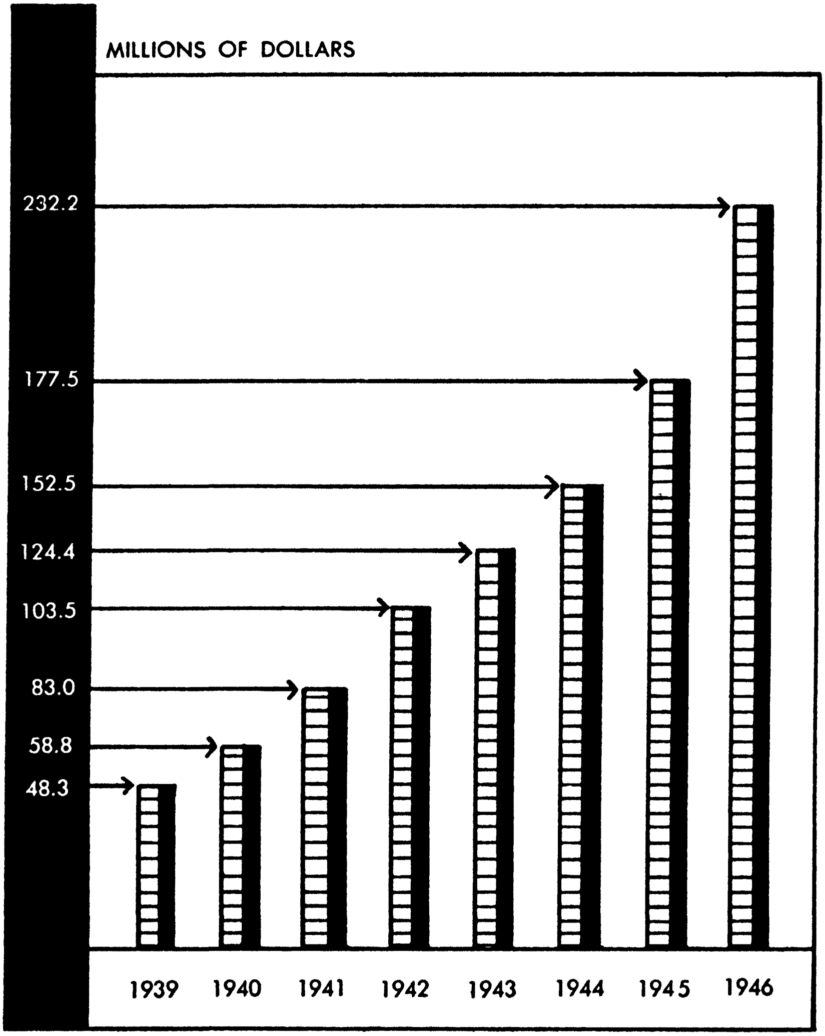
The cooperative movement has passed the first experimental stage, and it has been proved that, with efficient management and under favorable conditions, cooperatives are reasonably successful. It is true of cooperatives, as of all other worth-while efforts, that success is contingent upon good management and the loyalty and enthusiasm of the members. Education of members is a big factor in the success of cooperatives.

Cooperation has been notably successful in some of the European countries. At least up to the Second World War, cooperatives in Denmark and Sweden controlled and directed a considerable portion of the economic life of those countries. In most of the other European countries cooperative associations of various types have long been of noteworthy importance.

An interesting illustration of a consumer cooperative effort that started in a small way and developed into a huge success is the Rochdale Society in England. This organization was created in 1844 with a single store and a capital of about $140. From this modest beginning there developed various cooperatives. Today cooperatives in England do over 1 billion dollars of business yearly, with every other family being a member.

COOPERATIVES IN THIS COUNTRY

There are some successful consumers' cooperatives in this country, but progress is slow, and the sum total of tangible results is not impressive. In 1939 the retail sales through cooperatives amounted to something like ½ of 1 per cent of the total retail sales. It is enlightening to note that this compares with about 10 per cent of total sales through cooperative outlets in England.



WHOLESALE VOLUME OF THE REGIONAL MEMBERS OF NATIONAL COOPERATIVES, INC. (Courtesy of National Cooperatives, Inc)

It seems that marketing cooperatives have been somewhat more successful, although even here the proportion of cooperative sales to total sales is relatively small. Marketing cooperatives are chiefly in the area of farm products. Some outstanding examples are the Land O' Lakes Creameries, Inc., the California Fruit Growers Exchange, Inc., and the Staple Cotton Cooperative Association. In connection with dairy products, fruit, and vegetables, cooperatives play a prominent part; in some other lines there is but little of this type of marketing. The portion of our agricultural products marketed through cooperatives is approximately 12 per cent of the total.

WHY COOPERATIVES ARE NOT MORE SUCCESSFUL

The cooperative movement in this country is not a failure. In fact there are instances of excellent success. Nevertheless it has not grown by leaps and bounds as it has in some other countries; neither has it succeeded in making itself highly attractive to a majority of our people. There are several reasons for this, among which are the following:

1. We are used to the idea of individual competition rather than cooperation with groups.
2. We are not much impressed with small savings.
3. Many members of cooperatives are not sufficiently loyal to the group.
4. Many of the cooperative ventures have not attracted the best business talents.
5. It is sometimes claimed that the hope of private profit is the surest motivation for business efficiency.

FUTURE OF COOPERATIVES

It is at present impossible to say when, if ever, cooperatives will become a really important factor in our economic life. It has been found that an efficiently conducted cooperative may become quite profitable to its members. As experimentation goes on, better methods, plans, and types of organizations may develop. When such a movement once gets under way, it may make rapid progress largely by its own momentum. Success leads to further success. Growth begets growth. Progress, when well under way, frequently proceeds at an ever-accelerating speed.

SUMMARY

The essential feature of a cooperative is that it is operated for the direct benefit of its patrons, who are also wholly or largely the members of the cooperative association.

Cooperatives may be either consumers' cooperatives or producers' cooperatives. The purpose of the former is to buy more economically; the aim of the latter is to provide better marketing opportunities for its members.

In some countries cooperation plays a highly important role in the economic life of the community. In this country cooperatives have not yet reached such a high point of development. This is especially true of consumers' cooperatives.

QUESTIONS FOR REVIEW

1. What are the basic principles of cooperatives?
2. Define cooperative marketing.
3. What relation exists between patrons and members in a true cooperative?
4. Give some of the reasons for beginning cooperative marketing.
5. How are cooperatives and corporations similar? How do they differ?
6. What are some of the benefits derived by patrons and members of a marketing cooperative.
7. How is voting control in a cooperative regulated?
8. What inducement does a member of a cooperative have for investing in the cooperative? Does he have any motive for investing in more than one share?
9. How are "profits" of the cooperative distributed? Are they distributed to patrons or to members?
10. With whom does a cooperative conduct the bulk of its business?
11. What part does loyalty play in the success of a cooperative?
12. Does a cooperative eliminate the objection of charging "unreasonable prices"?
13. What synonomous terms are sometimes used instead of buyers' cooperatives and sellers' cooperatives?
14. Contrast the purpose of consumers' cooperatives with that of producers' cooperatives.
15. When one joins a consumers' cooperative, does this mean that he will "get everything wholesale"? Why?
16. Does eliminating the middleman mean that any *profit* he might have taken for himself is also eliminated? Does this necessarily mean that the cooperative will *gain?*

17. Does a consumers' cooperative have any reason for spending money on advertising and sales effort?
18. Have cooperatives been successful in this country? Give data to substantiate your answer.
19. Have cooperatives been successful in Europe? In England?
20. Give some basic data about the Rochdale Society.
21. Give illustrations of successful marketing cooperatives in this country.
22. Give four reasons why cooperatives have not attained noteworthy success in this country.
23. What can you say about the future of cooperatives in this country?

TERMS AND PHRASES TO DEFINE OR EXPLAIN

1. Consumers' cooperative
2. Sellers' cooperative
3. Producer's cooperative
4. Patronage
5. Buyers' cooperative
6. Cooperative

QUESTIONS FOR DISCUSSION

1. Why is it that in this country consumers' cooperatives quite frequently have been more successful when membership has been composed primarily of people of a given nationality?
2. It seems to be true that consumers' cooperatives particularly, in this country, have been reluctant to pay the necessary salaries to secure trained and competent business managerial ability. Why is this?
3. Mention some phases of cooperative management that are not likely to be handled efficiently when placed in the hands of untrained personnel.
4. Does a consumers' cooperative sell only to its members or also to the public? If it sells to the public also, does it sell to its members at the same price? How would you suggest that this problem be handled?
5. If a consumers' cooperative sells to the general public, would it have the same need for advertising and sales effort that other retail stores would have?
6. How might a cooperative go about building up and maintaining the cooperative spirit of loyalty among the members of its group?

A CASE PROBLEM

In the early days a consumers' cooperative association was formed among the residents of a small Danish community in America. It prospered and everyone was satisfied with it for some twenty-five years. In the meantime came good roads, automobiles, telephones, radio, newspapers and magazines, better education in near-by cities, etc., and gradually it found that it was losing the business of the younger generation in the community. Slight dissensions occasionally arose. Members found their interests expanding outside the community. Business fell off. Therefore the cooperative decided to compete more actively with other stores and so began to advertise, "dressed up" the store some, and started an "educational" campaign among its members. However, such activities proved expensive, so it was deemed necessary to cut down on other expenses. Various members took turns waiting on customers; the regular manager was released and replaced by the widow of a former member at a substantial saving in salary; cheaper quality of wrapping paper and supplies was used; etc. Eventually it was discovered that total value of assets owned had decreased considerably, and various members began asking to have the cooperative disbanded before they lost all their investments in it.

Point out some of the real reasons for the failure of this cooperative.

SUGGESTED PROJECTS

1. Compile a list of cooperatives of different types doing business in or near your locality. Attempt to determine whether each is a consumers' or a producers' cooperative.
2. Investigate and report on the origin, history, and present status of the California Fruit Growers Exchange, Inc.
3. Investigate and report on the origin, history, and present status of the Rochdale Society.
4. Determine whether your library has any current magazines devoted to cooperatives, and if so report on the names and contents of each.
5. Get complete information about some one cooperative in or near your community. Who are members? What is its purpose? How much must members invest? How and when are profits divided? What products does it handle? What buildings does it own and operate? Does it do a credit business?

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19. Basic ideas of distribution

PREVIEW: Business derives income from the sale of goods and services. A part of this income is distributed to those who participate in the production and sale of these products and services. Such distribution is made chiefly in the form of wages, interest, rent, and profits. Who are the claimants to the national income? How are wages determined? Is the national income distributed equitably?

OUR ECONOMIC PROCESSES MOVE IN A CONTINUOUS CIRCLE

In traveling around a circle you may use any place on the circle as a starting point. The same is true in the study of the series of continuous transactions that constitute our business and economic life. Production, sale, income, purchases, etc., each depends upon the others; and each follows the others in a sequence best described as a circle.

To make this clear, let us imagine that all business activity is momentarily stopped. Producers are all set to go. Producers, wholesalers, and retailers have certain stocks of goods on hand. Everybody has a certain amount of money.

Now we are ready to start traveling around the circle. We can start out at any point, but let us begin with the ultimate consumers. They go to the retail stores and buy. The retail stores use the money they receive to replenish their stock from the wholesalers. The wholesalers buy from the producers. The producers, finding their stock reduced, begin to produce and in this process pay out wages, interest, rent, and dividends. This, together with similar payments made by the middlemen, again puts money into the hands of consumers. Once more the consumers buy from the retailers; the retailers, from the wholesalers; the wholesalers, from the producers; and the circuitous process goes continually on.

THERE ARE MANY CLAIMANTS TO THE NATIONAL INCOME

The foregoing process is so continuous and so interwoven that it is somewhat difficult to view it in its various aspects. Let us for the sake of simplicity imagine that for a period of 1 month all business enterprises of the country have been on the receiving end. Everything has been coming in. Nothing has been going out. As a result of this the businessmen have accumulated, say, 5 billion dollars of distributable money. How is this money to be divided up?

A considerable portion of the 5 billion dollars will be paid out for wages. Interest will be paid out for borrowed money. Rent will be paid in cases where the concern does not own its premises. Other payments will be made to owners of patents, copyrights, etc. The balance represents profits and will be distributed to the owners or paid out in further wages, interest, etc., to expand the business.

It will thus be found that the income of the business is distributed to a considerable variety of claimants, all of whom took part in the productive processes. The income is distributed to claimants in the form of wages, interest, rent, and profits. Each of these shares will presently be considered, but first let us take a look at the national income as a whole.

NATIONAL INCOME NOT EASY TO DEFINE OR DETERMINE

There are many ways of defining and determining the national income. In a general work of this kind we cannot go into the intricacies of the problem but will be confined to the view that is perhaps the easiest to understand and that, to the extent that accurate figures are used, will arrive at a conclusion reasonably close to the reality.

The national income may be looked upon as the total amount received as wages, rent, interest, dividends, and profits plus the amount representing net increments in inventories and fixed assets. If we deduct the net increments plus individual net savings reinvested in business, there remains the *national dividend*—the amount that people actually spend on their various consumer needs. The national income is normally greater than the national dividend. There are, however, instances when the contrary is the case and people live partly on their savings. Such a process would of course be disastrous if long continued.

By way of illustration let us suppose that in a certain year the total national income is 120 billion dollars. Of this amount 11 billion dollars is saved and reinvested in business by people who received it as wages for services performed. Let us further assume that 9 billion dollars of profits was retained in the various business enterprises instead of being distributed. In such a case the result would be as follows:

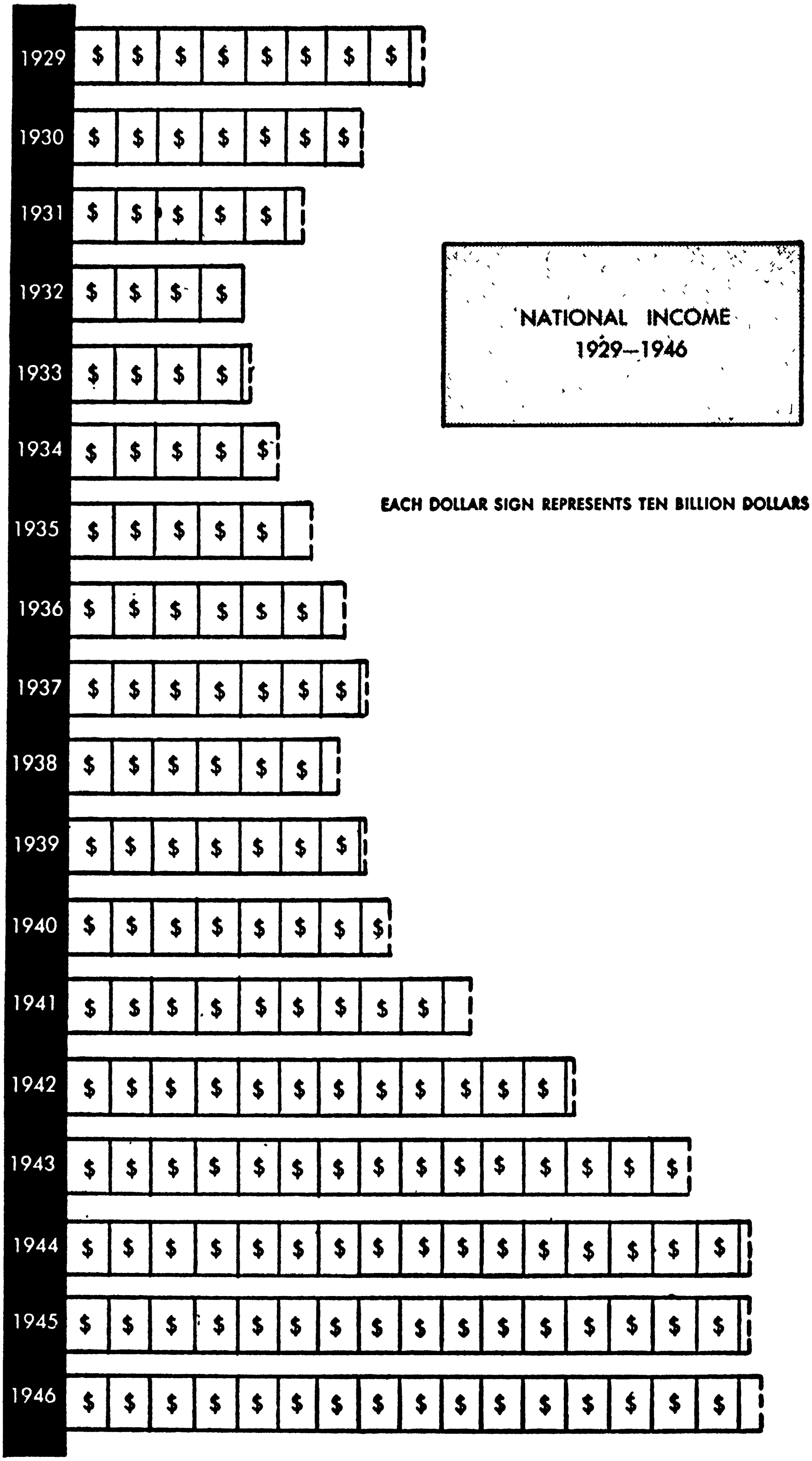
National income	$120,000,000,000
Savings ($11,000,000,000 + $9,000,000,000)	20,000,000,000
National dividend	$100,000,000,000

MONEY INCOME AT TIMES DECEPTIVE

A distinction should be made between *real* income and *money* income. The former represents the actual income in the form of units of service or commodities. The latter represents the income in monetary terms. In comparing the real income of different periods, we must take into consideration the general price level. People might be impressed with the fact that the money income of the nation over a given period had leaped from 80 to 120 billion dollars. The gain would not be quite so impressive after discovering that the price level during the same period had increased, say, 35 per cent.

The total real income will, by and large, determine the economic well-being of the vast majority of the people of the nation. Regardless of inequities in distribution, the best chance for each person to get much is to produce much. We all have a stake in total production. We should all be interested in increasing it.

The fact that a large *total* production is economically desirable does not necessarily imply that it is wise to produce a superabundance of any particular commodity or service. Strange as it may seem, too great an abundance of particular things may seriously impede our producing and distributing processes. The profit system depends on profits, and profits are usually derived from cre-



NATIONAL INCOME
1929–1946

EACH DOLLAR SIGN REPRESENTS TEN BILLION DOLLARS ating a relative scarcity of a given commodity. For instance, in a given country 1 million units of a given commodity might be sold at $10 a unit. If 3 million units were thrown on the market the price might go down to $1 or $2, which, no doubt, would be below the cost of production.

We cannot have too much of everything *in total,* but, from the viewpoint of a profitable market, we can, for instance, have too many shoes, dresses, tractors, houses, bricklayers, and schoolteachers.

WAGES THE BIG ITEM IN DISTRIBUTION

By wages we here mean any kind of compensation for personal services rendered in the process of production. The term thus includes what are commonly known as *wages,* besides salaries, commissions, fees, etc. From the viewpoint of most economists it is also made to include an allowance equivalent to the normal wages for business proprietors. Wage earners and salaried people in this country normally receive more than 60 per cent of the national income. If we consider wages in its broadest sense, the figure is not far from 80 per cent. In other words less than one-fourth of the national income goes for return on investment and for *pure* profit.

WHAT DETERMINES THE AMOUNT OF WAGES?

Ever since the advent of modern capitalism, economists have struggled wth the question of what determines wage levels in general and certain wages in particular. Some of the basic principles involved in determining wages will be examined.

It may be taken as axiomatic that no employer will long continue to pay wages that are so high that he will, as a result, suffer a loss on his business. On the other hand there are a number of marginal employers who, after paying their wages and other expenses, do not make any profit beyond interest return on their investment plus a wage reward for their own services. We may thus say that *wages will tend to equal what the least competent group of employers now operating are able to pay without suffering a loss.* If workers as a whole demand more than this, many of the less efficient employers will go out of business, and there may be widespread unemployment.

It will be seen from the above that the only way in which the general wage level can be increased and maintained is to increase production as a whole. To some extent it is true that high wages may in themselves produce greater efficiency and will thus pay for themselves. The preceding explanation of the determination of wages nevertheless remains true. It may be a moot question as to whether high wages create high production or high production creates high wages. As a matter of fact it works both ways.

The foregoing theoretical basis for wage determination is subject to many interfering elements in practice. Monopolies on the part of labor or capital, the influence of custom, humane considerations, and legislation are factors that frequently influence specific wage payments. However, on the whole and in the long run the principle explained above will assert itself.

INTEREST IS RETURN FOR THE USE OF MONEY

If everybody saved money and no one cared to borrow, there would be no interest. As a matter of fact there exists a considerable demand for money. There is only a limited amount of saving; therefore, if no interest rates were charged, there would be an insatiable demand for available funds. *Interest may therefore be said to be determined by the rate that will operate to limit the demand for funds to the amount of loanable funds available at a given time.*

This *law of interest,* like nearly all economic laws, represents a tendency rather than an invariable occurrence. In connection with any particular loan, many factors may enter in to cause variations from what we may call the *theoretical rate.* Skill in bargaining, time for repayment of loan, customary rates, relative safety of principal —these are all factors that enter in. These fluctuating elements, however, do not negate the general law of interest. If, with the same amount of loanable funds, the demand for loans increases, the only thing that will equalize demand and supply is an increase in interest. If the contrary is the case, interest must go down or the people having money to lend will not find sufficient call for their money.

Some people have the feeling that the moneylender is not quite as worthy of his reward as, for instance, a wage earner. This distinction between the two seems unfounded. Both perform services for which people obviously are willing to pay; and who shall say which of the two services is the more useful? True enough, some of the saving is done by people who are so rich that saving is not much of a sacrifice. This point is irrelevant. Contrary to an older economic idea, people are not to be rewarded in proportion to the pain they suffer, but rather in accordance with the services rendered.

NOT MUCH DIFFERENCE BETWEEN RENT AND INTEREST

In the terminology of economists the word *rent* was once confined to amounts allowed for the use of particular pieces of land or other fixed natural resources. In everyday terminology, and to a large extent among modern economists, rent now refers to any payments for the use of property as distinguished from the use of loanable funds.

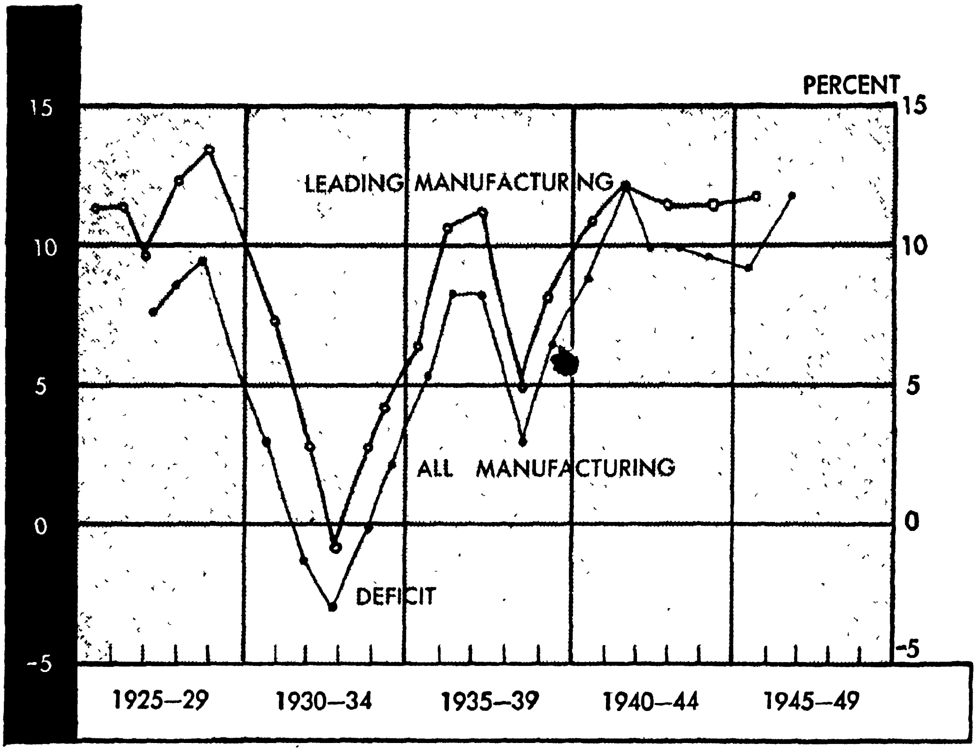
Rent and interest have some similarities. Both are rewards for savings and investments. A person will not usually invest in property unless he hopes to receive rent at least equivalent to what he would have received if he had lent out his money at interest. As a matter of fact, investors in property generally think in terms of interest returns on their investment.

There is, however, one important difference between buying property and loaning money at interest. If a person finds that a certain loan is not sufficiently profitable, he can cash in on it when due and invest in something else. If he invests in property, and if the returns become unfavorable, all he can do is to take what he can get or sell out at a loss.

Rent, like the two other forms of distribution that we have mentioned, is determined by the law of demand and supply. The economic law of rent may be stated as follows: *Rent is the amount charged to equalize the demand for properties of varying degrees of desirability.* For instance, if there were no rent, everybody would want the most fertile farming land. The rent for this land must be set sufficiently high so that returns will be slightly different to a prospective renter whether he takes the good land at high rent or much poorer land at little rent.

FINALLY WE HAVE THE QUESTION OF PROFITS

All the claimants to a share in the national income are seeking their share as a reward for some contribution to the national production. Profit is the reward for enterprise and for the willingness to assume risks. The hope of profit is the motivation behind the launchings of new economic enterprises. If it were not for the enticing lure of profits, the capitalistic system would speedily collapse.



ANNUAL RATE OF RETURN ON NET WORTH OF ALL MANUFACTURING CORPORATIONS AND LEADING MANUFACTURING CORPORATIONS. (Monthly Letter of National City Bank, New York, March, 1947.)

It is difficult to state a *law of profits* beyond the fact that it is the excess income that a successful businessman makes above that of less successful competitors who are barely making expenses plus wage and interest return for their toil and investment. Businessmen generally count as profits anything remaining after paying all expenses and making allowance for depreciation and other "noncash outlays." *Pure profit,* from an economic standpoint, does not begin to accrue until, in addition to all expenses, the businessman has allowed wage and interest returns for himself. Based on such a definition, profits are probably less common than is popularly supposed.

EQUITABLE DISTRIBUTION OF INCOME OF IMPORTANCE TO ALL

Our economic system does not always function smoothly and is subject to certain abuses on the part of self-seeking groups and individuals. However, many authorities and thoughtful people in general believe that the system of distribution that has been described is fundamentally sound and, with all its defects, perhaps results in a more equitable distribution than would be the case under a planned economy.

An equitable distribution of the national income is a problem of grave importance to everyone. If management keeps out too much in the form of wages and profits for itself, the workers suffer and in turn production suffers. If for a fairly long period of time any one group takes more than its equitable share of the income, the productive process is hampered, and the other groups are harmed.

SUMMARY

Distribution of income in a free competitive economy is taken care of chiefly through an automatic process and tends to reward each person according to the value of his contribution to the productive process. The reward of workers is called *wages*. Contributors of loanable funds receive *interest*. Persons who furnish properties for use are given *rent*. The explanation of the determination of what each tends to receive may best be explained by certain somewhat intricate formulas, but the basic factor is always the equalizing of demand and supply.

Profit is whatever is left over after all expenses are paid and the proprietor has received the proper returns for his services and investment. Profit is the motivation for business enterprise and is indispensable in a free economic society.

QUESTIONS FOR REVIEW

1. Trace the "circle" through which money travels from the consumer through the hands of middlemen and producer and back to the consumer.
2. In what four "forms," or for the payment of what four services, does our economic system distribute the national income among the people?
3. What is meant by the national income? How does this differ from the national dividend?
4. Distinguish between real income and money income. Why is it that the money income may at times be very misleading?
5. Just how important an item is wages in distribution of the national income?
6. State and explain the principle that determines the amount a country will distribute in the form of wages. How would increased production affect this if at all?
7. What is interest?
8. State and explain the principle determining the amount a nation will distribute in the form of interest.
9. Does one who lends money really "earn" his income as well as does one who works for wages?
10. Do you think it is equitable to reward people in accordance with the services they render?
11. How are rent and interest much alike? How do they differ?
12. State and explain the principle that determines the amount a nation will distribute in the form of rent.
13. For what should profit be considered to be a reward?
14. What is meant by pure profit?
15. If no one were allowed to receive over $5,000 income, to what extent would this increase the incomes of others? Is it possible that over a period of time it might actually result in a reduction in the income of others, too?
16. Why is the equitable distribution of income so important?

TERMS AND PHRASES TO DEFINE OR EXPLAIN

1. Wages
2. Interest
3. Profit
4. Rent
5. Distribution
6. Real income
7. Pure profit
8. Money income

9. National income
10. Capitalistic economy
11. National dividend
12. Planned economy

QUESTIONS FOR DISCUSSION

1. Is it perhaps possible to remedy some of the more obvious violations of equity in distribution of income without losing valuable advantages of our present economic system?
2. Is the amount of profit a business makes in any way a criterion by which the economic value of that business to the nation can be judged?
3. Can a nation afford to judge the desirability of its economic system without reference to accompanying social conditions?
4. If all citizens of a nation were to receive essentially equal incomes do you think the nation, as a nation, would be more contented? Do you think its standard of living would change in any way?
5. Since wages, interest, and rent are largely a matter of individual bargaining in thousands of specific cases, what assurance can we possibly have that our present system results in a distribution of the money income in a manner that is even approximately equitable?

CASE PROBLEMS

1. A certain college professor once voluntarily resigned from a position that he enjoyed very much to accept an almost identical position in another college at a considerably reduced salary. He stated his reason for doing this was to increase his standard of living and his savings account. How could he arrive at such a conclusion under the circumstances?
2. During 1943 a secretary from a small town in Iowa worked for 6 months in a war plant at $225 per month. She returned to her home town then to accept a secretarial position at $100 per month, and stated that she would save more money there. Does this seem reasonable?
3. A soapbox orator was heard to say, "Every adult in these United States is entitled to an income of at least $3,000 per year. Do we each of us get it? No! And I say we never will so long as the decision is left in the hands of selfish profiteers who are allowed to retain all they do not pay us." Criticize this statement.

SUGGESTED PROJECT

Consult the following magazines, as assigned by your instructor, or such other periodicals as your instructor may assign, and report to the class the general nature of any articles, data, or comments you can find bearing on the distribution of the national income to any of the four main groups of productive factors.

American City
American Economic Review
Business Week
Economic Geography
Economist
Fortune
Journal of Economic History
Journal of Economic Education
Monthly Labor Review
Survey Graphic
Taxes

REFERENCES

Ault, Otho C., and Ernest J. Eberling: "Principles and Problems of Economics," Chaps. XVI–XIX.

Fairchild, F. R., E. S. Furniss, and N. S. Buck: "Economics," Chaps. XIV–XVII.

20. Statistics and accounting

PREVIEW: Statistical data and accounting records are important tools of business. They provide reliable and practical information as a basis for making many managerial decisions. Financial records are necessary if a business is to be at all successful. What are some of the important statistical devices? How may statistical data be presented? What information is contained in the financial statements of a business?

BUSINESS MUST HAVE RECORDS AND STATISTICS

Statistics and record keeping serve many useful purposes. In modern business they are practically indispensable. The general principles underlying statistics are the same wherever used, but it is customary to classify them according to the particular functions they are to serve. Thus we have educational statistics, population statistics, mortality statistics, etc. Statistics applied to economics and business are referred to as *economic statistics* and *business statistics,* respectively. Record keeping when applied to business is called *accounting.*

Statistics and accounting are introduced in the unit on "Dividing the Proceeds" because, among other purposes, these devices serve the purpose of revealing just how wealth and income are actually distributed. They represent the only methods we have for dispelling many popular misconceptions concerning such distribution. By means of accounting we can show what the financial relationships are in a particular business. Statistics of a regional or national scope will present the same information over a broader field. We shall first present a few basic facts about statistics and accounting and shall then show how statistics and accounting may be used as devices for measuring the distribution of wealth and income.

WHY ARE STATISTICS SO IMPORTANT?

Without statistics it would be impossible to present certain economic facts. National wealth and income; status and trends of wages and interest rates, profits, etc.; changes in the price level and wholesale prices; cost of living; status and changes in business condition; and the relative importance of various business units are a few of the fields in which statistics furnish invaluable information.

Nothing is more detrimental to correct economic thinking than lack of reliable information. Statistics help give us the proper balance and perspective. Generalizations based on rumors, unproved assertions, and emotional appeals are the tools used by demagogues and mob psychologists. To meet prejudices and falsification, it is necessary not only to be able to read statistics but also to be able to interpret them.

MEASURES OF CENTRAL TENDENCY ARE USEFUL DEVICES

A mass of jumbled figures is useless until we arrive at some specific conclusion by what is known as a *measure of central tendency.* A measure of central tendency is some figure typical of the group. The most important measures of central tendency are the *mode,* the *median,* and the *mean* (sometimes called the average). Each of these serves a particular purpose, and the one we choose depends upon the nature of the data and the purpose we have in mind.

The various measures of central tendency can best be illustrated by arranging a series of figures from the highest down. For the purpose we shall present the following:

Arrangement of Figures

82
80
79
70
66
65
64
60
60
60
55
50
40
35
30
25
22
20
20
15
10

The *mode* is the figure that appears most frequently. In the tabulation the mode is 60. Although this is not always typical of the group, it is useful whenever we are interested in finding out something about the most numerous *identical* grouping.

The *median* is the figure that has as many cases above it as are below it. In the tabulation the median is 55. The median is easy to arrive at, since all you need to do is to arrange the figures in proper sequence as shown and then take the middle figure.

To arrive at the *mean* is a little more laborious. The process is to add up the figures and divide the sum by the number of cases. For instance, in the tabulation, 1,008 (the total of the columns) ÷ 21 (number of items) = 48, the mean.

By the typical figure we mean the one that has a better chance of being close to the truth than any other figure that we might select. For instance, the average weight of men is 156 pounds. If without seeing a man you guess that he weighs 156 pounds, you have a better chance of being close to the truth than by guessing any other figure. A teacher assigning a median grade to all his students would hit upon the correct grade much more frequently than one who assigns all superior grades or all failures.

Which is the more nearly typical—the median or the mean? That depends upon the nature of the data. If no figure in the series is disproportionately large or small the mean serves the purpose very well. If such disproportions exist it is better to use the median. For instance, if one man attending church gave $100 and 100 others each gave from 5 to 50 cents it would be very misleading to say that the typical gift was over a dollar. In such a case the median is the number to use. The average in this case would show that the typical person gave over a dollar. The fact is that only one person gave above 50 cents. The median would probably show about 30 cents, which would be the one figure closest to what a majority of the churchgoers gave.

HOW TO PRESENT STATISTICS

Most people have difficulty in grasping the significance of statistics. For this reason various devices are used for the purpose of making the findings more intelligible. The most common methods are as follows:

1. The use of percentages
2. The use of index figures
3. The use of graphic presentation

If a series of figures is presented, even a person who is mathematically inclined has some difficulty in grasping the relative importance of the different numbers. Here percentages come to the rescue, since the comparable figures will then be reduced to a scale of 100. To say that in a certain business A has 70 per cent ownership; B, 20 per cent; and C, 10 per cent may be more meaningful than to say that they have $5,350, $2,100, and $1,050, respectively.

Index figures are an extension of the use of percentages. We start at a base point, calling this 100, and then record the changes from this point on a percentage basis. For instance, if wheat in 1914 (the base point) sold at 80 cents, a later price of $1.20, 50 per cent more, would be shown by an index of 150. The accompanying table will serve as an illustration.

Formula

$$\frac{\text{Sales of any year}}{\text{Sales of base year}} = \text{index number, or relative sales of particular year.}$$

Pictorial presentations of statistical facts are made by means of various types of graphs. There is considerable possibility of variations in graphic presentation. They may be broadly divided into

Index Numbers Illustrated

Year	*Sales in Dollars*	*Index number of sales*
1926	$162,000	100
1927	191,000	117
1928	211,000	130
1929	200,000	123
1930	195,000	120
1931	180,000	111
1932	142,000	87
1933	111,000	68
1934	160,000	98
1935	186,000	114

area graphs and *lineal* graphs. Sometimes we may have a combination of both.

ACCOUNTING IS A CUMULATIVE HISTORY OF A BUSINESS

It would be impossible for a business to get along without at least some periodic information concerning its operations. The extent to which such information is needed depends upon the size, complexity, and nature of the business. Certain financial statements derived from records are essential for managerial control, for control of assets and liabilities, for reports to owners concerning their investment, and for reports to the government.

We have at times referred to accounting and financial statements in an incidental way. We shall now make a somewhat more complete review of the scope and nature of accounting as a whole.

DOUBLE ENTRY IS BASED ON THE BALANCE-SHEET EQUATION

Double entry is a bookkeeping system that provides a complete record of all the assets, liabilities, and proprietorship items of a business, including detailed information concerning the operations of the business. When these requirements are fulfilled, the books will automatically show a balanced set of accounts. In other words, when we make a list of balances in the form of a trial balance, the sum of the two sides will be equal.

Double entry is based on what is known as the balance-sheet equation. We all know that if we substract what we owe from what we have, the balance represents what we are worth. From this we derive the following fundamental equation:

Assets — liabilities = proprietorship
$10,000 — $3,000 = $7,000

These facts may be restated in another form to read as follows:

Assets = liabilities + proprietorship
$10,000 = $3,000 + $7,000

It is the latter form that is used as a basis for double-entry systems.

A mere statement of the *total* assets, liabilities, and proprietorship is not very informative. We must know more about the component parts included under these headings. To illustrate this we present below a somewhat condensed form of a typical balance sheet for a small corporation:

The Day and Knight Company

BALANCE SHEET

December 31, 1946

Assets			*Liabilities*		
Current:			Current:		
Cash	$ 1,500		Accounts payable ...	$ 3,000	
Accounts receivable ..	7,500		Note payable	1,000	$ 4,000
Notes receivable	1,500		Fixed:		
Inventories	6,500	$17,000	Mortgage payable		8,000
Fixed:			Total liabilities		$12,000
Equipment (net)	5,000		*Proprietorship*		
Buildings (net)	40,000	45,000	Capital stock .	$50,000	
Deferred charges:			Surplus	2,000	
Prepaid insurance ...	500		Total proprietorship		52,000
Prepaid rent	1,500	2,000			
		$64,000			$64,000

Note that, notwithstanding the many items involved, the two sides balance. It follows that the accounts, from the balances of which these figures are drawn, must also present a set of records in which the total of the balances representing assets will equal the total of the balances representing liabilities and proprietorship.

It will be noted that assets, liabilities, and proprietorship are further divided under appropriate headings. Each of these headings will now be briefly explained:

Current assets. Cash and assets that will soon be converted into cash.

Fixed assets. Assets of a somewhat permanent nature that are used in the conduct of the business.

Deferred charges. Expenditures incurred in the present period but which will benefit subsequent periods.

Current liabilities. Debts that will be due in the near future.

Fixed liabilities. Long-term indebtedness.

Capital stock. This usually represents the original investment.

Surplus. Proprietorship in excess of capital stock. Surplus usually arises from earnings retained in the business.

The balance sheet presented provides examples of the different accounts that come under each of these groupings.

SOME STATEMENTS SUPPLEMENT THE BALANCE SHEET

The balance sheet shows the *condition* of a business *as of a given date,* but it does not provide any direct information concerning the *success of operations over a given period.* The latter is the function of the statement of profit and loss. The balance sheet shows us the financial status at which we have arrived. The statement of profit and loss shows us *how* we arrived.

A statement of profit and loss may vary considerably in form, depending upon the nature and size of the business and the amount of detail desired. The example given below is for a merchandising concern and is presented chiefly to show the various parts that such a statement usually contains.

The balance sheet and statement of profit and loss may be supplemented by any number of other statements and schedules. Thus we may have schedules of accounts and notes receivable, accounts and notes payable, and lists of the various other classes of assets. The different parts of the statement of profit and loss may be set out in separate schedules, and only the summarized figures shown on the principal statement.

The Day and Knight Company

STATEMENT OF PROFIT AND LOSS

January 1 to December 31, 1946

Sales			$120,000
Cost of sales:			
Inventory, January 1, 1944		$ 8,000	
Purchases		90,000	
Goods available for sale		98,000	
Less inventory, December 31		9,000	
Cost of goods sold			89,000
Gross profit			31,000
Operating expenses:			
Selling expenses:			
Salesmen's salaries	$10,000		
Delivery expense	4,000		
Advertising	2,000		
Supplies	500		
Miscellaneous	200	16,700	
Administration and general expenses:			
Office salaries	4,000		
Rent	1,500		
Depreciation	400		
Supplies	400		
Loss from bad debts	200		
Miscellaneous	300	6,800	
Total expenses			23,500
Net operating profit			7,500
Other income:			
Interest earned	150		
Discount on purchases	500	650	
Other expenses:			
Interest cost	100		
Discount on sales	400	500	150
Net income of business			$ 7,650

PROFIT-AND-LOSS STATEMENT SHOWS DISTRIBUTION WITHIN A BUSINESS

Many of the disputes involving distribution of income in connection with a particular concern could be eliminated if the contending parties made an intelligent analysis of the financial statements of the concern. For instance, the adequacy of wages, the fairness of prices charged customers, the question of reasonable profits to the proprietors, and efficiency of operation may be largely determined by a study of these statements.

By way of illustration let us take the foregoing statement of profit and loss. In the light of this statement, we shall consider

1. The adequacy of the salaries
2. The fairness of prices
3. The adequacy of profits
4. The efficiency of operation

The statement does not reveal how much each person is getting. It does, however, give some indication of how much more the proprietor can afford to pay. Assuming that one-half of the delivery expense, or $2,000, consists of salaries, the total salary expense is $16,000. The net profit to the proprietor is $7,650. This is before allowance for the proprietor's services and some return for his investment and risk. Everything considered, it appears that if the proprietor should be compelled to make a substantial salary increase, other things being equal, he might better go out of business, lend out his money at interest, and work for somebody at a salary.

Is this proprietor charging too much for his goods? Again the statement gives the answer. It shows that his prices, on the whole, are not excessive. The sales amount to $120,000. The net operating profit is $7,500, or slightly over 6 per cent. An over-all reduction of 5 per cent in prices would practically wipe out his profits. Even a reduction of 3 per cent would probably leave him an unprofitable return for his services and investment.

The question as to whether or not the proprietor is making a fair profit has already been partly answered. However, to arrive at a conclusive answer we must know the amount of his invested capital. Assuming that his services to the business are worth $3,000, the return on capital is $4,650. This return would be fair on an investment of $50,000. However, considering the risks of business, it would be a meager return on an investment of $100,000.

The question of efficiency of operation cannot be answered from the evidence on the statement alone. It is necessary to check the evidence of competitors in the same line of business. Very often statements of previous years are compared to determine if present costs are in line with other years. Salaries, prices, and profits are all dependent upon the efficient operation of the business.

The foregoing study does not necessarily purport to represent a typical situation. The statement and discussions are presented merely as an example of how we may attack the questions of wages, profits, prices, etc., through the examination and analysis of financial statements.

ARE PROFITS GENERALLY EXCESSIVE?

When we wish to find the answer to questions relating to wages, profits, prices, etc., for a region or for the nation as a whole, we must turn to economic and business statistics. The Federal government and other agencies compile figures that, except for a small margin of probable error, give a fairly true picture of the situation. When we talk about wealth and income distribution on the basis of these figures our statements are backed up by the most reliable information available.

It is not our purpose to make any dogmatic statement as to whether profits are too high, or too low, or just right. That may be a matter of opinion even after the facts are revealed. We shall merely present a few figures and let the reader draw his own conclusions.

If we asked several persons at random as to how big a portion of our national income goes to the relatively rich in the form of profit, interest, rent, etc., the answers would range from something like 50 per cent down to practically nothing.

In 1946, according to statistics compiled by the U.S. Department of Commerce, the national income was $165,000,000,000. This income was distributed as follows:

Total national income		$165,000,000,000
Distribution:		
To employees	$110,000,000,000	
Farmers	15,000,000,000	
Unincorporated businesses, doctors, lawyers, etc.	15,000,000,000	
Corporation profit	12,000,000,000	
Rent and interest	13,000,000,000	
Total	$165,000,000,000	$165,000,000,000

It can be seen that 66 per cent of our national income goes to people working for wages and salaries. Farmers and laborers combined get 76 per cent. The large group of professional people and small businessmen whose incomes do not greatly exceed a fair salary return receive 9 per cent. This means that the remainder, 15 per cent, goes to a relatively small group in the form of profit, interest, and rent.

FURTHER STUDY DESIRABLE

In an introductory book of this kind our survey of accounting and statistics with their application is of necessity superficial and fragmentary. It is hoped that this introduction will reveal the need for further study in these useful fields. Regardless of how clear a thinker a person may be, he cannot get far with the solution of business and economic problems without an extensive and judicious use of statistics.

SUMMARY

Statistics provide us with indispensable business, economic, and social information. The ability to read statistics and draw the proper conclusions prevents people from becoming the victims of rumors, exaggerations, and propaganda.

Accounting provides much economic information of a broad nature. Its chief purpose, however, is to offer current financial information for the guidance of particular business concerns. A complete set of accounts is known as a *double-entry* system. The double-entry system of keeping books is desirable, both because of its completeness, and because it provides a balanced set of bookkeeping accounts. The basis of double-entry bookkeeping is the balance sheet, in which assets = liabilities + proprietorship.

Accounting and statistics are both useful devices as indicators of the actual distribution of income. Accounting furnishes this information for particular concerns Statistics cover the field on a regional and national scale.

QUESTIONS FOR REVIEW

1. Name some kinds of statistics classified according to functions.
2. Why are statistics studied in this text in connection with the unit on "Dividing the Proceeds"?

3. Why are statistics so important?
4. Name and briefly explain three important measures of central tendency. What are some of the factors determining which one should be used in any given set of circumstances?
5. What are three common methods of presenting statistics? Give illustrations of the use of each.
6. Why does a business need statistics?
7. Explain what is meant by the balance-sheet equation. In what two forms may it be stated?
8. Distinguish between the information shown by a balance sheet and that shown by a profit-and-loss statement.
9. Outline the general arrangement of the information in these two statements.
10. What information can you give bearing on the question of whether or not profits in general are excessive?

TERMS AND PHRASES TO DEFINE OR EXPLAIN

1. Mode
2. Mean
3. Median
4. Statistics
5. Index figures
6. Area graphs
7. Percentages
8. Lineal graphs
9. Selling expenses
10. Balance-sheet equation
11. Deferred charges
12. Business statistics
13. Interest earned

QUESTIONS FOR DISCUSSION

1. What types of statistics might be of particular interest to one who is trying to decide whether to become a teacher?
2. What mortality statistics might be of interest to an insurance company?
3. What types of statistics might a labor union be interested in?
4. How might one tell whether or not employees of a certain company are being paid a fair wage?
5. If you were seeking to determine representative wages of a group of 20,000 workers in a certain industry, what statistical measurements might you use?
6. Under what condition might the mean (arithmetical average) be considerably different than the median?
7. Which method of presenting statistics do you think the average

reader can comprehend more readily—percentage, index figures, or graphs? Give illustrations to substantiate your answer.

8. If a black area 1 inch square (area graph) were used to denote 100 acres, what size square should then be used to denote 200 acres?
9. Does the manager of a business need any statistical information other than that contained in the balance sheet and the statement of profit and loss?
10. Just what would you say constitutes an adequate profit?

CASE PROBLEMS

1. Mr. Thornton Brookmire has decided to start a retail clothing store but is undecided whether to locate it in the town of Excelsior or in the town of Eureka. What are some of the statistics he might obtain to assist in making the decision intelligently?
2. A small group of laborers in the Connelly Manufacturing Company are dissatisfied and claim that the management is "profiteering" and at the same time paying inadequate wages to its laborers. What type of statistics might be presented to help decide whether or not their claim is just?
3. An employee, Joe Larkins, shows his employer recently published government statistics indicating that the cost of living index stands at 135. On the same basis, he also points out that his salary index would be only 115, and he therefore requests an increase in salary. Do you think he has a good case for himself? Can you think of any other information that might be pertinent?

SUGGESTED PROJECTS

1. Check through several current issues of *Survey Graphic* or some similar publication suggested by your instructor and summarize for the class some of the methods of graphical presentation of statistics found there.
2. Consult the U.S. Bureau of Labor Statistics *Monthly Bulletin* and report to the class the types of statistics found therein and the methods of presentation commonly used. Would this same summary also apply to the *Monthly Labor Review?*
3. Clip from old newspapers and magazines various types of statistical information presented in graph form—lineal graphs, area graphs, pictographs, etc.—and bring them to class. Have a committee of students responsible for preparing a "display of graphs" from these clippings.

4. Investigate the following government publications and become familiar with the type of statistical information to be found in each:
   - a. *Census of Distribution,* United States.
   - b. *Census of Manufactures,* United States.
   - c. *Commerce Reports,* Bureau of Foreign and Domestic Commerce.
   - d. *Domestic Commerce,* Bureau of Foreign and Domestic Commerce.
   - e. *Market Data Handbook* of the United States.
   - f. *Monthly Labor Review,* Bureau of Labor Statistics.
   - g. *Statistical Abstract of the United States,* Department of Commerce.
   - h. *Statistical Atlas,* Department of Commerce.
   - i. *Survey of Current Business,* Department of Commerce.

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Unit Seven • BUYING THE GOODS AND SERVICES

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21. Problems of the consumer

PREVIEW: Everyone must decide how he shall spend his money. After this decision has been made the next step is to buy, as wisely as possible, what is wanted. The consumer can, by thoughtful planning of expenditures, improve his own standard of living. What are some of the important problems facing the consumer? What are some of the factors of wise spending?

THE ECONOMIC CIRCLE AGAIN

In Chapter 19 we described the economic processes of production, distribution, and consumption as endlessly traveling in a circle. Little has been said about the consumption aspect of this seemingly endless process. Specific attention will now be given the problems confronting the consumer in his efforts to buy wisely.

Let us first of all distinguish, from an economic standpoint, between desire and demand. A *desire* is any kind of a wish or yearning which we may or may not satisfy. A *demand* is a desire coupled with the willingness and financial ability to buy. I may sit looking at the wintry moon wishing I were in the Sunny South, but I don't feel that I can spare the money—that is desire. The next day I unexpectedly get some money and I go to the station and ask for a ticket to California or Florida—that is demand.

Now let us get back to the circle. In Chapter 19 we spoke about the payment of money by the consumers as being our starting point around the circle. In one sense it all begins with desire that, unless the price is too high, is translated into effective demand, resulting in payment of money to the retailer, and the merry chase around the circle is on once more.

As a matter of fact, desires, demand, production, income, distribution, and consumption all react upon one another. Producers watch closely what people desire and mold their production accordingly. On the other hand the abundant production of certain goods may lower the price to such an extent that even people with relatively slight desire for the goods will nevertheless buy. Finally the size and distribution of the national income have an important direct bearing upon demand and, indirectly, upon production.

IT IS OURS TO SPEND

We may think of our monthly national income as being a pile of money, say, 10 billion dollars waiting to be once more put into circulation. What are we, the people of the United States, going to do with all this money? Well, outside possible rationing and other legal restrictions, we can do with it exactly as we, individually and collectively, please. The right to spend our own money as we wish is one of our most prized privileges.

There lies before us a great choice of procedures. For most people it is a difficult choice. We each have a limited amount of purchasing power with seemingly an almost unlimited number of things that we might wish to buy. The problem is to get the most that we can for our money. Sometimes the manner in which we spend our money is almost as important as the amount of money that we receive.

BUT WHAT IS WISE SPENDING?

The economist, as such, does not attempt to moralize or philosophize on the virtues of particular types of human desires. As a moralist, a social thinker, a religionist, an educator, or a philosopher he may be much concerned that the spending should result in the moral, physical, and spiritual uplift of the individual and redound to the benefit of society. Purely as an economist he studies merely how economic desires are satisfied. Whether or not these desires are good or bad, wise or foolish, from a moral, social, or religious standpoint is outside the sphere of pure economics.

Our discussions in this unit will be partly descriptive and partly advisory. To the extent that we give advice, we shall take a stand about midway between the economist and moralist. We shall not attempt to list certain particular desires as good and others as bad. We are, however, going to show how a person's *real* desires, whatever they are, may be satisfied in the fullest measure *in the long run.*

WHAT ARE SOME IMPORTANT FACTORS OF WISE SPENDING?

There are two ways of increasing one's material well-being. One is to increase the income. The other is to make what is available go as far as possible. It is with the second procedure that we are especially concerned at present. Among the various methods for stretching the family income, the following are important:

1. Make a wise choice of living standard.
2. Decide what you really want and avoid mere impulses.
3. Use a budget.
4. Get information about what you buy.
5. Study various markets.
6. Use most economical procedures.
7. Avoid pure waste.
8. Make use of consumer facilities offered.
9. Plan for long-range needs.

The first eight suggestions will be considered in this chapter. The last point will be covered in Chapter 22.

CHOOSING A LIVING STANDARD

We frequently hear reference to something called the "standard of living." No doubt a reasonably high standard of living is very desirable, and we should strive to get an income that will make such a standard possible. However, nothing is gained by aspiring to a standard of living that a person's present and potential income does not justify. On the contrary, such a policy usually results in nothing but disappointment, worry, and discontent.

In keeping within one's income it is seldom necessary to give up any major comfort and semiluxury entirely. It is merely a matter of cutting down somewhat proportionately on each item. With an annual income of, say, $2,500 rather than $4,000 you will simply live in a cheaper house, eat less expensive food, buy fewer and less fashionable clothes, own a cheaper car and drive it less, and have fewer social functions and paid amusements.

When a person has once settled down to a certain standard, assuming that it is reasonably comfortable, it is no hardship to maintain it. The thing that really hurts is to try to maintain an impossibly high standard or to be forced to drop from a certain standard to a lower one.

A few people make the mistake of living on too low a standard. Everybody should save something, but even here a virtue carried to excess may become a vice. Distinguish between *thrift* and *miserliness*. Thrift is wisely planned spending, in connection with which a saving and investment program should play a part. Miserliness is aimless saving and deprivation.

DECIDE WHAT YOU REALLY WANT

A weeping child was asked what the trouble was. He said, "I bought some lemonade." "But why should you cry about that?" "Well," he said, "the lemonade is gone. If I had spent the money for peanuts, I'd still be eating."

This story illustrates an important principle. Presumably a person always buys that which, for the moment, he most wants. But does he? Sudden impulses, sales pressure, desire to make a showing, and pure thoughtlessness frequently impel a person to make the same mistake as the boy with the lemonade. Planning and reflection are prerequisites of wise spending, and wise spending is buying what in the long run you really want.

SET UP A BUDGET

In planning your particular standard of living and deciding just how you should divide your limited resources, a budget is of great help. A budget is a planned estimate of future income and outlays and is used as a control for your finances. *Living on a budget* means that you make a definite periodic allowance for expenses and savings and then restrict yourself to those allowances.

A budget does not need to be an elaborate system. All you necessarily need to do is to put down what you propose to allow for each type of expenditure such as food, clothing, housing, etc., and then keep some kind of classified record to show how much you spend currently on each, to prevent you from inadvertently exceeding your budget. The setting up of a budget does not of itself assure systematic spending but is a constant reminder of your good resolutions.

GET INFORMATION ABOUT WHAT YOU BUY

There is an old saying that "you get what you pay for." The implication is that quality is always commensurate with price and that all you need to do in order to get a given quality is to pay the price.

There is some truth in this statement; however, there are several reasons why the rule of price is not a safe and invariable guide to a proper selection of your purchases.

In the first place high quality may not be essential to your purpose. Don't buy a high-priced article when a cheaper article will be almost equally acceptable. Furthermore just what particular quality do you want? If all you want is durability, don't pay for style. If you primarily want utility why pay extra money for appearance? Finally it must be remembered that various markets may sell the same thing at different prices. This is what we mean by choosing your market. Most important is the fact that price is not always a reliable guide to quality.

Certain "consumer services" make helpful evaluations of the relative worth of certain competing articles. Various government agencies and private business organizations also publish useful buying guides for the consumer.

STUDY VARIOUS MARKETS

The final advice is to deal with businesses that have a good reputation. Avoid what are popularly known as "gyp stores." Such places have alluring advertisements and may at times have real bargains. In the long run one is indeed fortunate not to suffer a loss. After all, every dealer must make expenses, and there is no reason to believe that a fly-by-night concern has lower selling expenses than a reliable and well-established merchant.

USE THE MOST ECONOMICAL PROCEDURE

Closely related to the idea of wise choice of quality is the question of economical ways of *doing* things. Economize on your time, your effort, your strength, your health. Decide whether it is more economical to hire a thing done than to attempt to do it yourself. If you are going to travel, what, everything considered, is the most economical method? If you need a house to live in, which is cheaper —to buy or to pay rent?

These are only samples of the many questions that arise in connection with the choice of procedures. Time is money. Health and strength are your most precious assets. Economize these somewhat intangible but very real possessions.

AVOID WASTE

A few years ago a book called "Orchids on Your Budget" was published. The main thesis of the book was that a few luxuries should if possible be a part of every man's life. We believe that the author's philosophy was essentially sound. "Man does not live by bread alone." Neither is life nothing but a matter of food, clothing, and shelter. Sometimes people are willing to forgo a portion of so-called bare necessities in order to acquire some favored luxury. Within reasonable limits there is no particular objection to this attitude. A few petty extravagances may constitute the very spice that helps make life worth while.

But when it comes to waste, we have quite a different matter. Buy orchids if you please but don't waste them. Buy that car you have been wanting but don't ruin it when you get it. Have plenty of good things to eat but don't throw one-third of it away.

There is a far cry between waste and extravagance. Extravagance is frequently foolish; sometimes it is vicious, but it usually serves some purpose. Waste is aimless, purposeless, and indefensible. The superfluous fuel that you consume when you are out of the house, the light you leave burning in a vacant room, the good food that you throw into the garbage can serve no purpose whatever.

MAKE USE OF FACILITIES OFFERED

All about us there are facilities available that can be used at little or no expense. They should be made use of. As examples of such we may mention libraries, parks, playgrounds, inexpensive clubs, churches, night schools, radio, lectures, and inexpensive wholesome entertainments. In addition to this, the government—Federal, state, and local—offers numerous services that many people overlook.

Much money can be saved by arranging for free or inexpensive home enjoyments. These are usually both cheaper and better than most public amusements. It is not necessary to tour the town in order to have enjoyment and entertainment. Get acquainted with your neighbor. You may like him.

SUMMARY

It is desirable to have a good income, but the enjoyment you may derive from whatever income you have may be greatly augmented by careful planning.

Do not try to overreach yourself. If you cannot obtain more than a relatively small income, settle down to the situation and make the best of it. There are contented people in practically any income group, and discontent is a malady that is not confined to the poor.

The keynote to successful spending is planning, and your planning should be evidenced by some kind of a budget. Such a budget should always provide for spending a little less than you take in. A few luxuries and even some favorite extravagances may not be out of place if you keep within your means, but waste is never defensible.

QUESTIONS FOR REVIEW

1. Economically speaking, what is the difference between desire and demand?
2. Is there any relation between demand and production? between demand and the distribution of the national income?
3. Does the problem of spending our income seem to be a difficult one?

4. Can the economist alone give adequate advice as to what is wise spending?
5. Indicate several methods that may be used to assure maximum benefits from your purchases.
6. If one's standard of living is found to be too high for his income, does this mean that he must "cut out" something?
7. What is the distinction between thrift and miserliness?
8. What is meant by "living on a budget"? What is the purpose of it?
9. Does one usually get what he pays for?
10. Does a higher price always indicate greater utility?
11. Will the price be the same at all competing stores? Will it vary as between cities?
12. Is it more economical to do things yourself whenever you can rather than to hire some things done?
13. Are all extravagances to be considered ill-advised?
14. What is the difference between an extravagance and a waste?
15. What types of facilities often are not used to the fullest extent?

TERMS AND PHRASES TO DEFINE OR EXPLAIN

1. Economic desire
2. Waste
3. Economic demand
4. Thrift
5. Extravagance
6. Budget

QUESTIONS FOR DISCUSSION

1. When automobiles first appeared, most people poked fun at them. Many articles pointed out the extreme danger to health resulting from traveling at the high speed of 20 miles per hour. Undoubtedly there was little if any desire for them, and certainly no demand. Today the demand has become tremendous; they are considered a necessity. By what process has this great change in attitude come about?
2. Vacuum cleaners are today pretty much considered to be a necessity; the demand is large. Originally there was not even a desire for them. Has this demand developed through somewhat the same process as the development of the demand for automobiles?
3. If a family receiving an income of $2,500 and enjoying a reasonable standard of living were to suddenly have its income increased to $5,000, how much of this increase do you think the family likely would save?

4. Does the adoption and use of a budget for a family result in getting less enjoyment out of the family income?
5. Why is it that some people will spend $25 in an evening of entertainment at night clubs while other people will be just as happy spending the evening at home, at the library, or at the park at no expense?
6. As an educator, would you advise one to spend all leisure evenings with friends at home?
7. Would a factory laborer likely spend the same amount for clothing that would be needed by a $10,000 a year business executive? How would the needs of these two people compare with the needs of a schoolteacher in a small town?
8. If a successful attorney were also a high-speed and expert typist, would it be wise for him to do his own typing?

CASE PROBLEMS

1. A certain college professor of speech completely owns and lives in a nice-looking and reasonably well-constructed house that he built entirely himself during his leisure time. Of course it took him several years to build the house, and during this time he did little else other than to teach his classes—which he did in an acceptable manner. Do you think he spent his time and ability wisely?
2. Mr. Ahrens receives a salary of $4,000 per year. His position is relatively secure. He states that he does not need a budget in the usual sense of the term, for he simply pays his regular monthly insurance and old-age annuity premiums, his monthly rent, food bills, etc., and if anything is left, knows that he can spend it as he wishes. What do you think of his "plan"?
3. George Freeman customarily buys all his clothing from the Enterline Clothing Company. Mr. Enterline has operated this clothing store the past 50 years, and Mr. Freeman has patronized him for many years. Mr. Freeman asks and accepts the advice of this clothing store relative to the quality and value of all his purchases. Do you think Mr. Freeman buys wisely?
4. George Freely subscribes to a certain consumers' advisory service that issues periodical evaluations of various types of merchandise, rating various brands of merchandise in an objective manner. He always consults this service before making a purchase and then buys definitely in accordance with such advice. Do you think Mr. Freely buys wisely?
5. Truman Tralsdine makes a practice of always paying cash for his

purchases. Accordingly he also always attempts to get the merchant to reduce his price somewhat "for cash" and rather proudly asserts that he never buys an article unless he is given a reduction in the price asked. Do you think Mr. Tralsdine buys wisely?

SUGGESTED PROJECTS

1. Secure and present to the class an illustrative family budget.
2. Consult recent issues of *Consumers' Guide* or some similar type of service recommended by your instructor and explain the method and type of advice or evaluations given there.
3. Prepare a report on "Consumer Information Furnished by Business."
4. Prepare a report on "Consumer Information Furnished by Consumer Organizations."
5. Invite some qualified businessman or woman to talk to the class or to some arranged evening meeting about consumer information that the business world is furnishing. This may be well limited to the particular type of information that the speaker has available.

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22. Savings, investments, and life insurance

PREVIEW: It is difficult for most people to provide properly for the future. There are, however, many opportunities for making financial provision for the future. It is important that everyone make plans in order to minimize the chances of losing his money in poor investments. In what should one place his money to provide for the future? How much should one set aside to take care of his needs adequately?

THRIFT AND SAVING NOT IDENTICAL

A person who is thrifty will do some saving, but saving and thrift are not synonymous terms. The term *thrift* has come to mean wise spending. This statement becomes clearer when we consider the fact that saving and investing are really nothing but another form of spending. When we spend for our daily needs, we are satisfying our present desires. When we spend in the form of investments, we are providing for our future needs. There should be a proper balance between the two. It is certainly improvident and foolish not to make reasonable provision for the future. At the same time there is no point in denying unduly present-day needs in the hope of having plenty several decades hence.

The reason why so much is said about providing for the future is that so few people do it in adequate measure. It is easy to spend all one's money for everyday needs. To most people, saving for the future is painful.

WHY SHOULD WE SAVE AND INVEST?

The painfulness of saving, everything else being equal, increases in reverse order with the amount of income. The greater the income, the easier it is to save. A family man with an income of less than $2,000 a year may find it difficult to save anything. A person with an income of 2 million dollars is practically compelled to save. He has no reasonable way of spending more than a small fraction of his income.

If at all possible, everybody should save a portion of his income. But why? We all have the general idea that it is a good thing to save, but what are the specific purposes of saving and investing? Here are a few of them:

1. To increase one's independence of action. A person who has some savings can, for instance, afford to leave his job to seek a better one. This may be difficult for the man whose only protection against starvation is his next pay check.
2. To have financial means for availing oneself of opportunities. Many people are unable to take advantage of an opportunity because they just cannot raise the money to finance it.
3. To provide for sickness, temporary unemployment, and unforeseen expenses.
4. To be able to buy some desired thing in the future.
5. To provide against the possibility of total and permanent disability.
6. To provide for dependents in case of death.
7. To provide for old-age retirement.

Few people are able to provide adequately for all the above contingencies; still fewer are willing to do it. However, a start can be made in the right direction. Periodic savings need not be so great if only they are systematic and continuous.

FIRST FORMULATE A PLAN

Sporadic savings never lead to any great results. A plan must be made out, and this plan should be followed conscientiously unless some unforeseen calamity occurs. Treat savings as a part of the budget. Look upon savings as being almost as compulsory as rent.

Do not make a savings plan too ambitious. Carefully study prospective needs so that the plan will not be an unbearable burden. It is better to save less than to embark upon a plan subject to frequent breakdowns.

LET US TAKE A CONCRETE EXAMPLE

Let us suppose that you are thirty years old with a wife and two children, and that you expect to retire at the age of sixty-five. You decide the you can save $400 a year. The first thing you should have is life insurance. Let us suppose that you have $7,500 in one or more ordinary life policies. (The characteristics of different kinds of policies will be discussed in a later section.) This will cost you about $150 a year. Seven thousand five hundred dollars is not much life insurance, but it will at least save your family from immediate destitution. In addition, if you are covered by Federal Social Security, your wife and small children would be eligible for survivors' benefits from that source. Death in your thirties is rather unlikely, and, as time goes on, savings will accumulate to augment what you can leave if the worst should happen.

The next thing you should do is to provide a fund of ready cash. At the end of 3 years, counting a small rate of interest, you will have accumulated about $800. This should be in such a form as to be readily available when needed; for example, $200 might be in a checking account; $200 might be in a bank savings account or in postal savings. The balance of $400 might be in bonds that can be disposed of at any time without a loss. Perhaps United States government bonds would be best for this purpose.

You have already made a good step forward. You are taking care of a reasonable amount of life insurance. You have money in the bank for your current needs. You have a backlog of assurance against some temporary misfortune. Best of all, you have gained a certain amount of independence and are in a position to avail yourself of opportunities where ready cash is the determining factor.

YOU ARE NOW READY FOR THE LONG PULL

You are now thirty-three years old. You have 32 years to go before you are sixty-five. Since your immediate and emergency needs are now taken care of, your next purpose will be to continue to swell your permanent nest egg, culminating in a retirement income at sixty-five. Can you do it?

Although your income should increase and you should accordingly save more, assume that, after keeping up your life insurance, you continue to save $250 a year. The deposits alone in 32 years amount to $8,000, but that is not the whole story. You will be making interest and compound interest. If you can average as much as 3 per cent on your investment, compounded annually, you will at the age of sixty-five have an accumulation from this source amounting to $13,135. In addition to this you will have the original $800 that you had at the end of the third year (with some interest) plus something like $4,000 cash surrender value on your life insurance. Altogether, you would be worth something like $18,000, and all you needed to do to accomplish this was to save $400 a year.

You are of course free to handle your $18,000 in any way that you see fit, but let us suppose that you use the money to buy a life annuity—giving you a monthly income for life. On this annuity you would receive over $1,300 a year. You would not be living in luxury, but you would be well removed from destitution. Furthermore you will likely be eligible for Social Security retirement benefits, or you will be able to continue to earn some money after you are sixty-five.

The idea of buying an annuity is only one suggestion out of many. Part of your money may already be invested in a home. Perhaps when you reach the age of sixty-five you have some money invested in stocks, bonds, mortgages, and real property. There is no particular harm in continuing these investments. There is just one guiding principle—safety and a steady return are the chief considerations when you have nothing to live on but the returns from your investments.

The foregoing is only one possible plan of several. The essential pattern is illustrated by the example—life insurance, available cash in the bank, savings account, and building for the future. The amounts of course may vary from person to person; however, with but few exceptions the average person should adopt a plan very similar to the one suggested. It should be pointed out also that the plan, once adopted, should be modified from time to time as your changing circumstances indicate. For example, most young men will earn more money as they grow older. Furthermore as their standard of living increases so will their need for savings and life-insurance protection. Consequently in actual practice the amounts set aside in the ways we have indicated will normally be increased from time to time through the years.

WHAT ARE THE ELEMENTS OF A GOOD INVESTMENT?

If no one took any chances in business, there would be little progress. However, in working out such a program for saving as we have explained, it is not often that a person can be too conservative. It may be that you have some extra money with which you may enter into a venture involving a certain amount of risk, but, before you do this, set aside a certain amount each year in a safe investment.

There are several elements to consider in connection with investments, and much depends on an individual's situation and the purpose that his money is to serve. The following are some basic things to consider in every investment:

1. Safety of principal
2. Satisfactory returns
3. Ease of conversion into cash
4. Appropriateness to the needs of the investor

No investment can be expected to possess *all* these good points to a high degree. You will usually have to sacrifice one in part, for the others. For instance, an investment that promises a high return is seldom as safe as one that will yield a relatively low return. Furthermore, providing for contingencies that may arise at any time requires an investment that is easily converted into cash. This is unnecessary and may even be undesirable when the saving is for old age.

THERE ARE MANY INVESTMENT POSSIBILITIES

When we discussed our savings and investment plan we said little about the manner of investment beyond the fact that the investor might hope to earn a rate of 3 per cent. A pretty good general rule is to have a variety of conservative investments. Among such investments the following may be listed:

1. Deferred annuities
2. Savings-association shares
3. Government bonds
4. Other high-grade bonds
5. High-grade stock
6. Individual mortgages
7. Home ownership

Many people find it best to invest all their savings in deferred annuities or in some plan offered by some kind of savings association. Others buy government bonds. These investments have certain advantages, chief of which is safety. However, a person who is both wise and careful may sometimes increase his returns by also investing in some of the offerings yielding a higher return on the investment, thus balancing his program.

Particularly in savings for old-age retirement, deferred annuities have certain decided advantages. A person, say at the age of thirty, makes a contract with a life-insurance company to deposit a definite amount periodically. These deposits, together with a small amount of compound interest, accumulate until a certain age, commonly sixty-five. The company then pays back the accumulation to the annuitant in the form of monthly payments for the rest of the annuitant's life or for some other designated period. This plan ties the investor down to definite payments while the fund is accumulating and can be so arranged that the annuitant is assured of at least some income as long as he lives after the date of retirement.

Savings deposits, if systematically carried out, may serve a purpose somewhat similar to annuities. The difficulty is that there is more temptation to discontinue the deposits and even to draw out some or all of the proceeds. The reason for this is that savings deposits can, upon short notice, be drawn out in full. In the case of most annuities a person will not get quite the full benefit from his deposits unless he continues the contract till maturity.

Government bonds have a high degree of safety, and the same is true of many other high-grade bonds yielding a low rate of interest. As a provision for old-age retirement these securities suffer from the same defect as savings deposits—they can easily be converted into immediate cash.

Corporation stock and individual mortgages usually promise higher returns than the forms of investments we have mentioned so far. On the other hand there is a greater possibility of loss. For the average and relatively poorly informed investor it would be unwise to stake more than a minor portion of the savings in this type of securities. In the case of stock, safety can be increased by diversification, since you are then not "placing all your eggs in one basket." One difficulty is that a person with small savings does not have enough money with which to buy a considerable variety of securities.

SHOULD YOU INVEST IN A HOME?

You frequently hear people say, "Paying rent is like throwing money away." This is a gross exaggeration. The renter, by paying rent, saves the expenses incidental to ownership. Furthermore there are situations in which it is not feasible to own a home. This may at times be true in a very large city, or in any case if a person's occupation requires frequent moving. Neither should a person buy a house on the basis of a small down payment unless he is reasonably sure of an adequate and steady future income.

No one should jump to the conclusion that it is always cheaper to own a home than to pay rent. The decision should be based on calculations, rather than on hunches, hearsays, and emotions. When you pay rent, you know what it costs you. If you are to compare the relative cost of ownership, you must consider the following:

1. Interest on borrowed money, if any
2. Interest on your own investment
3. Taxes
4. Insurance

5. Repairs
6. Depreciation
7. Risks incidental to property ownership

The chances are that it is usually a reasonably good investment to own your own home if that is possible. But that is not all. The permanency, security, and pride of possession that follow from home ownership are returns that cannot be precisely measured in money terms. The actual saving in terms of money is usually not so great as many people suppose.

THEN THERE IS LIFE INSURANCE

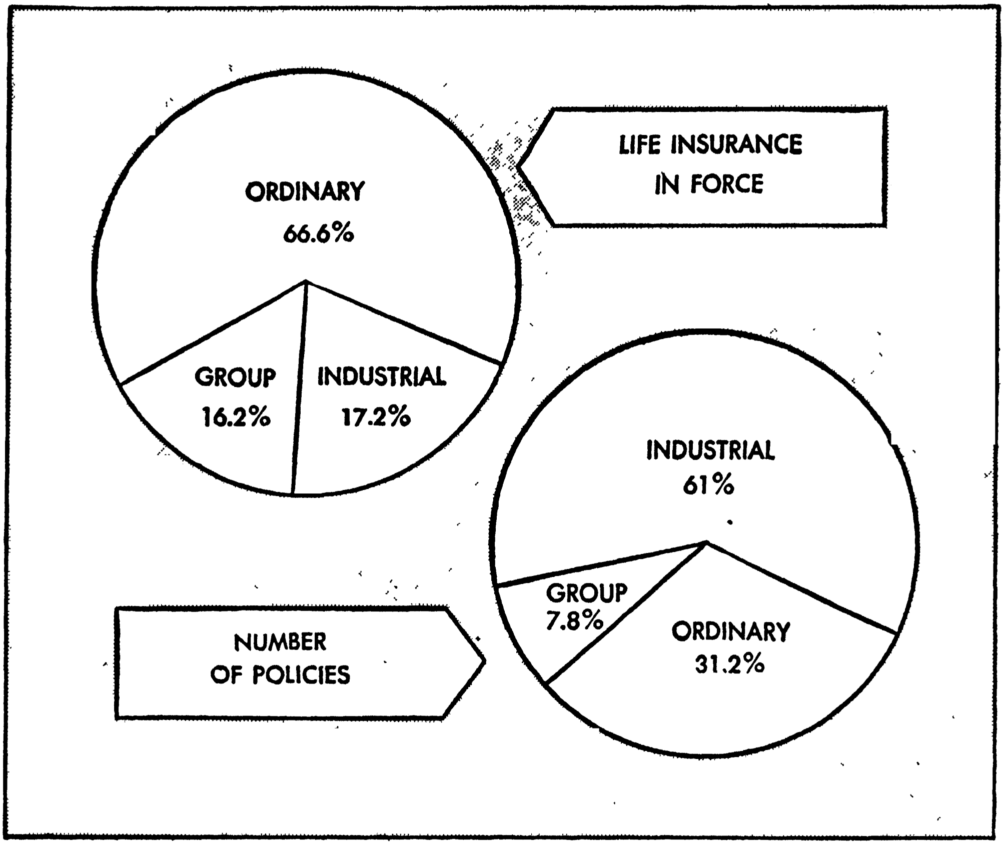
When we laid out our hypothetical savings plan we started out by buying $7,500 of life insurance. There was a reason for that. Life insurance is the only method yet devised that, upon payment of a small initial sum, will immediately give a man assurance that his dependents will be cared for in case of an untimely death. If our thirty-year-old friend had known for sure that he was going to live till he was at least sixty-five, he might still have dealt with an insurance company; but he would not then have bought insurance—he would have bought an annuity payable at the age of sixty-five.

This brings out a point that is not always understood—life-insurance policies may be classified as follows:

1. Temporary protection—term insurance
2. Permanent protection—whole life insurance
3. Protection and investment—endowment life insurance

Protection is *the essence* of life insurance, and some insurance policies provide nothing but protection. Such policies provide the maximum amount of protection for the money you pay out. By adding something more to this basic sum, your policy still gives you only as much protection as it did before, but the extra amounts will be credited to you and accumulate in your favor as an investment. The amount you pay for protection is an outright expense. This does not mean that the money has been wasted. In return for a relatively small periodic payment you have protected your dependents against the possibilities of financial destitution. The peace of mind provided by carrying a reasonable amount of insurance protection may be well worth the price.

It is impossible to generalize on the question of whether you should take insurance for protection only or add certain investment features. It all depends on your situation. If above all things you want to provide for your family in case of your death, buy protection. If you want both protection and investment, buy both; but remember you have to pay for both. If you don't need protection at all, don't waste your money paying for it. Take out an annuity or engage in some other systematic investment plan.

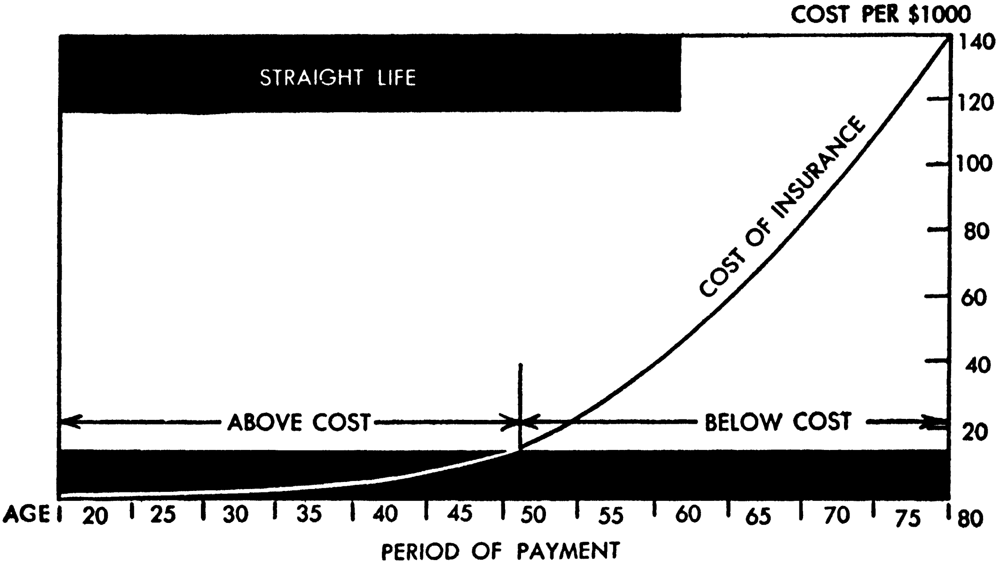


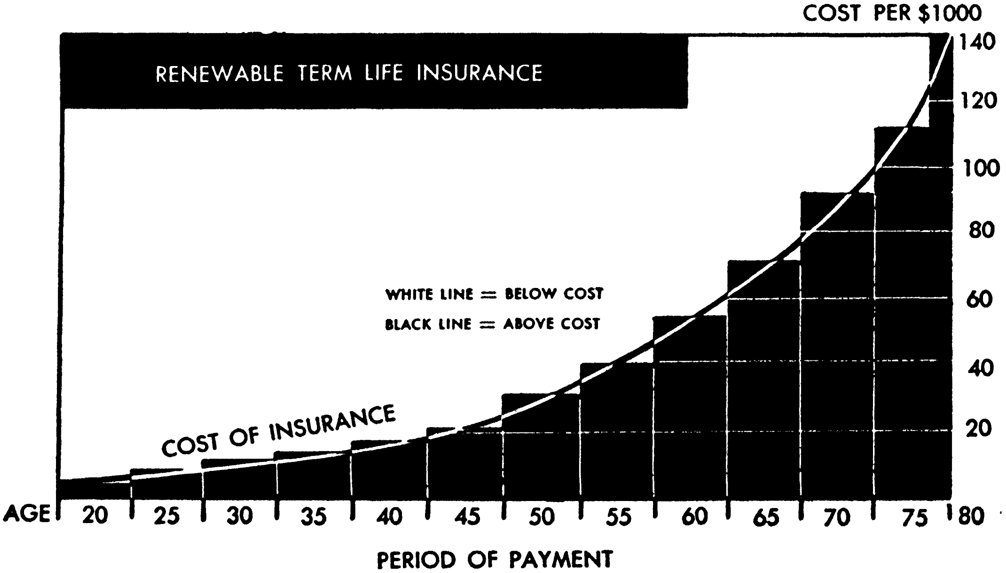
AMOUNT OF LIFE INSURANCE IN THE UNITED STATES

A POLICY FOR EVERY NEED

A good life-insurance agent will recommend the particular policy or policies to fit your individual needs. Every policy may be grouped under one or the other of the following general types:

1. Term policy. Provides temporary protection only. Premiums are paid for a limited period of time, after which the policy expires. No investment features.

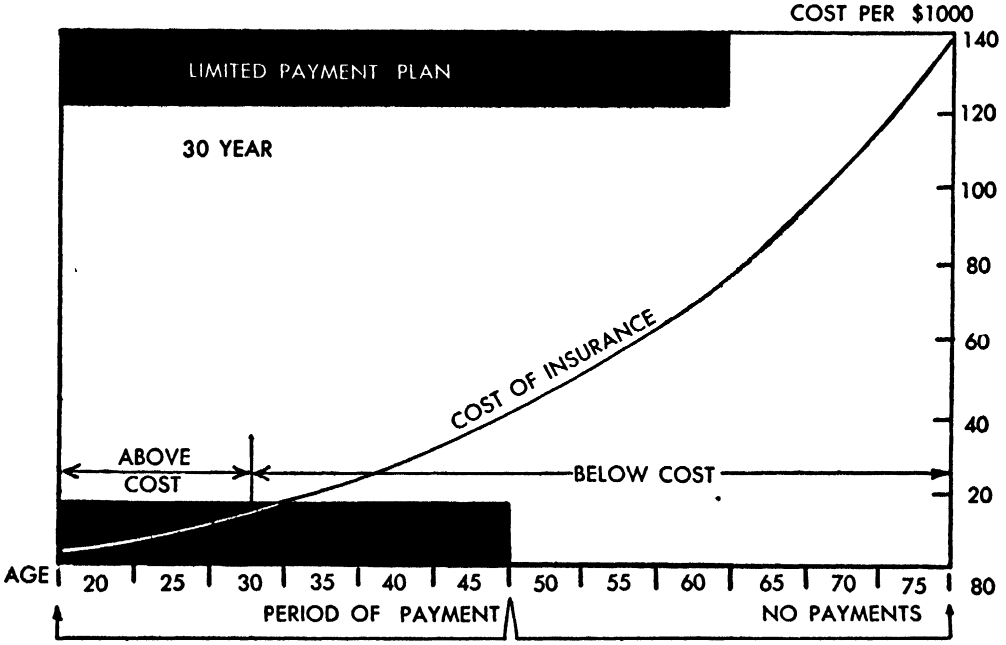


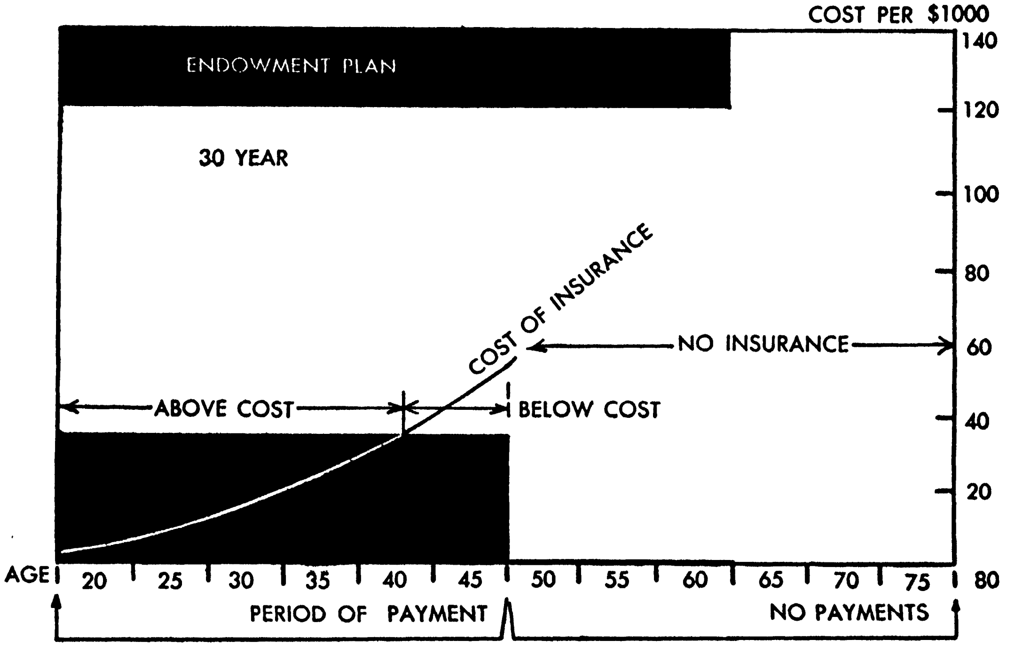


2. Ordinary whole life, or straight life, policy. Premiums are paid for a lifetime, and the policy becomes payable at death. If the insured wishes to discontinue the policy, he can col-

lect a cash value representing a portion of what he has paid in or accept a paid-up policy of an amount considerably less than the original.

3. Limited-payment whole life policy. Premiums are paid for a limited time, say, 30 years or prior death. After that time no





more premiums are due. The policy becomes payable at death. Other features are similar to ordinary life.

4. Endowment policy. Combines protection and investment. Provides for accumulation of a sum of money during a specified period, such as 20 or 30 years, or prior to age sixty-five. Policy becomes payable to insured if alive at that time or to someone named in the policy if he dies during endowment period. Premiums payable to maturity or may be limited as in case of limited-payment whole life.

It will be noted that the basis for the differences existing among these policies is the question of added investment feature. The term policy is purely for protection. At the other extreme an endowment policy emphasizes investment. That is why the latter costs several times as much per $1,000 of insurance as the term policy. If a person takes out a term policy his beneficiary will, in event of death, get as much as if the same amount were taken out under an endowment policy. But if the insured lives, no one gets anything except the benefit of the protection paid for.

SUMMARY

Saving and thrift are not synonomous terms. A thrifty person will do some saving, but thrift is essentially wise spending. Saving and investing is in itself a form of spending.

Saving and investing should be based on a plan. This plan should be scrupulously and systematically carried out. Saving is useful both for various contingencies and to provide a fund on which to retire when reaching old age.

There are many good investments. A good investment should combine safety of principal with a reasonable return. In addition to this, it should be easy to convert into money when needed and should fulfill the investor's specific requirements.

Home ownership is generally a good investment, but we should not entertain exaggerated ideas of the economy derived from such ownership. Some of the more intangible satisfactions derived from ownership are frequently of more importance than the possible monetary gain.

Life insurance should generally find a place in a person's investment program. The essence of life insurance is protection for dependents, but it is possible to add certain investment features. It is highly important that a person select the type of insurance best suited to his needs.

QUESTIONS FOR REVIEW

1. Distinguish between thrift and saving. How are they related to spending?
2. Is it any easier to save when one's income is large?
3. Give several good reasons why everyone needs to save.
4. A plan for savings usually accomplishes most. Why is this?
5. Is it better to start with an ambitious plan or with just a reasonable one?
6. Give an example to illustrate the accumulation resulting from small regular savings properly invested.
7. Can one who is able to save no more than $400 per year expect to save sufficiently to provide security for self and family during later years?
8. What are the basic elements of a good investment?
9. What types of investments are available?
10. How may one go about intelligently deciding whether or not to invest in a home?
11. When one buys life insurance, for what is he actually paying?
12. Describe the essentials of each of the following types of insurance policies: term; ordinary whole life; limited-payment whole life; endowment.

TERMS AND PHRASES TO DEFINE OR EXPLAIN

1. Savings
2. Insurance protection
3. Ordinary whole life insurance
4. Investment
5. Term life insurance
6. Limited-payment whole life insurance
7. Life annuity
8. Endowment insurance
9. Annuitant

QUESTIONS FOR DISCUSSION

1. To what extent is habit important in any long-range savings program?
2. At approximately what age may one reasonably expect to reach

his maximum income? Will this vary along various occupations and professions?

3. Does one usually find his largest expense bills to be during youth, middle age, or old age? Will this vary with people?
4. Would it seem wiser to invest in stocks and bonds or in life insurance and annuities?
5. Is there any one type of investment that completely meets all the requisites of the most desirable type of investment? Does anything seem to approach it?
6. What problems would be involved if one decided to invest funds in individual mortgages?
7. Is there any reason why a girl just finishing college should carry life insurance?
8. Is there any reason why a college freshman who is working his way through college should be thrifty? Is there any reason why he should have a budget? Is there any reason why he should adopt a plan for saving?

CASE PROBLEMS

1. Jack L. Simpson is married and twenty-eight years old and has a small son. He rents an attractive small home at $40 per month but is considering whether he should buy another house that is for sale at $8,000. He could pay only $2,000 in cash and could receive the remaining $6,000 at 6 per cent interest. He has decided it would be cheaper to continue renting. Do you think he is deciding wisely, assuming the price of $8,000 to be reasonable?
2. Miss Lois Kettleson, aged thirty-eight, has inherited $5,000, which she wishes to invest. She is debating whether she should invest it in an annuity or in stock that has been paying 6 per cent dividends or in a home. What advice can you offer for her consideration?

SUGGESTED PROJECTS

1. Ask a local life-insurance representative to explain the various combinations of savings and of investment that his policies have to offer.
2. Consult recent issues of *American Home* or of other magazines recommended by your instructor and report on any articles found that help in deciding whether it may be more economical to rent or to own a home.
3. Talk with a local real-estate representative and get information

about relative costs of owning (buying) and of renting homes. Report your information to the class.

4. Find out from a representative of some life-insurance company how much it would cost per month to purchase an annuity of $200 per month due at age sixty-five if payments are started at age twenty-five.

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Unit Eight • PRODUCTION FOR USE

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23. Government services

PREVIEW: The operations of the government do not arise from a profit motive, in the usual sense; but such operations are financed chiefly through compulsory taxation rather than through receipts from voluntary purchases. Since these services are already paid for by taxation, they are usually made available to individuals without any further charge. What are some of the important services rendered by the government? Why are not these services provided by private business? Should these services be expanded or contracted?

PRODUCTION FOR USE VS. PRODUCTION FOR PROFIT

At this point it is well to remind ourselves how our many needs are provided for through competitive enterprise. Business concerns operate for profit, people save and invest to receive interest and rent, laborers work in order to get wages. In no case is the primary objective that of providing an abundance of goods and services for the teeming millions. Rather it is true that each person is usually intent upon making as much as he honestly can for himself. We are producing for *profit* rather than for *use.* We have found that the system works reasonably well. We cannot continue to make profit, interest, rent, and wages unless we produce what people want. Hence our efforts are perforce directed toward producing an abundance of just what people want.

Production for use approaches the problem from another and a more direct angle. The proper governmental agencies determine certain things they think people need, or should have, and then go ahead and produce accordingly. The products and services of this type are in most cases fully or largely financed through public taxation. In some cases there is a charge to the individual using the services for a portion of the cost; for instance, a person attending a state university usually pays some tuition; in some it is entirely free. Sometimes the services are of such a nature that they cannot be said to apply to any particular individual. Examples of this are police protection and national defense. In a few instances acceptance of the services is compulsory, in others it is a matter of private choice. For instance, parents are compelled to send their children to school. The use of public recreational facilities, bridges, highways, etc., is usually optional.

THERE IS MUCH PRODUCTION FOR USE

A cursory view of the situation might lead us to the conclusion that production for use in this country is relatively insignificant. Our food, clothing, fuel, shelter, and other such necessities are generally provided for us by private enterprise. Where, then, does the government come in? Where is our production for use?

There are various reasons why we do not always realize how much we receive from the government. In the first place, most of the services do not require a direct payment but are provided for by tax money. In the next place, many services do not apply directly to our daily life. Finally a considerable portion of the products and services goes only to a portion of the population, especially to those who are in need. Those in more fortunate circumstances do not always realize the social importance of relieving physical want whenever necessary.

Just what portion of our total satisfactions do we get from the government? The best available measurement is in the terms of the amount paid out. In normal times we pay from 20 to 25 per cent of our income to the local, state, and national governments. During the Second World War this rose to something like 50 per cent. This does not mean that each person pays the same percentage of his income. For instance, in the case of the income tax, those with small incomes pay little or nothing. The very rich pay the greater portion of their income. On the assumption that we get our money's worth, we may thus conclude that at least 20 per cent of our wants are normally supplied by the government and about 80 per cent from private sources. In time of war or other national emergency the government plays a far more preponderant part.

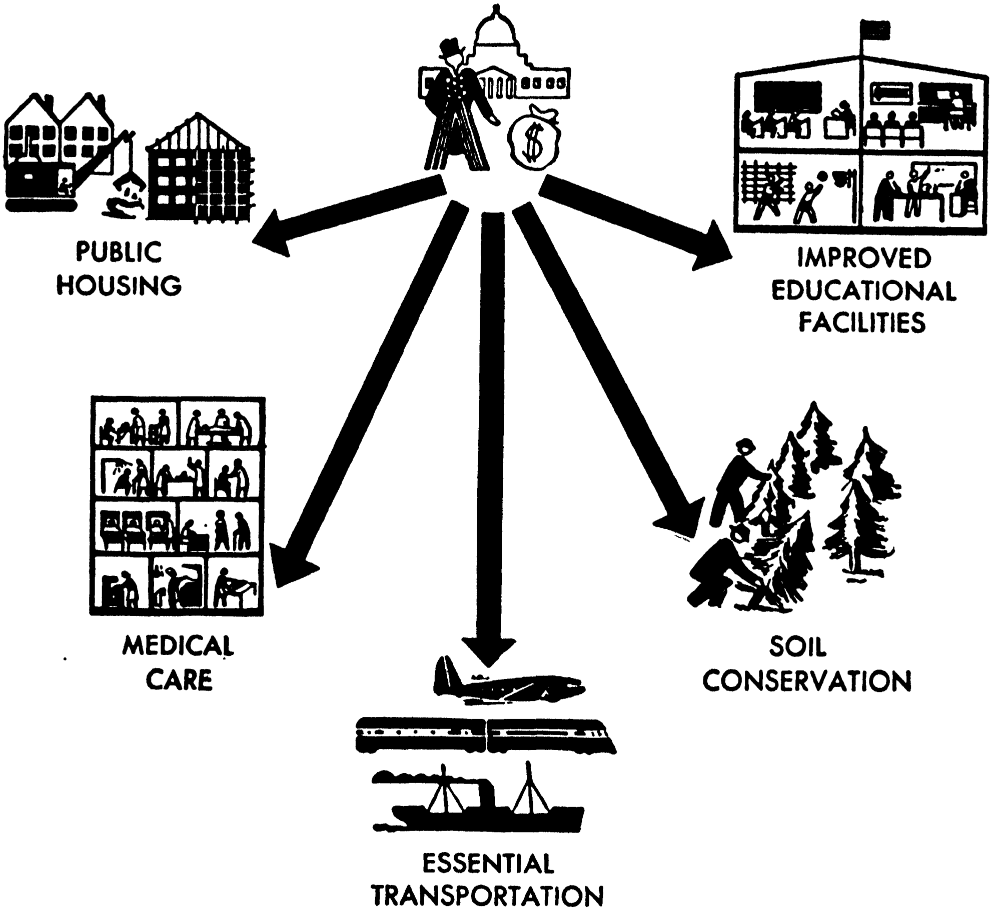
It may help to clarify our thinking about government services if we present a partial list of the benefits received from this source. Some of the important services rendered by the Federal, state, and local governments are as follows:

1. Police protection
2. Protection against fire and other hazards
3. Public health service
4. National defense against foreign aggression
5. Streets and highways
6. Education
7. Parks, playgrounds, and other recreational facilities
8. Conservation of natural resources
9. Improvement of harbors and waterways
10. Development of foreign commerce
11. Encouragement and promotion of commerce and industry
12. Regulation of business with a view to public good
13. Assistance for those who are mentally or physically handicapped
14. Protection against economic destitution

When we read this rather long, and yet incomplete, list, we begin to realize that our tax money is not thrown away after all. Perhaps we do get our money's worth. Education and use of highways alone, if purchased from private sources on a business basis, would use up a good portion of what we normally pay. Certain services, like protection against foreign and internal enemies, could not well be entrusted to private business.

WHAT IS THE REASONABLE LIMIT TO PRODUCTION FOR USE?

The government could conceivably branch out into fields not taken care of by private enterprise until we should eventually receive everything on the basis of "production for use." This is the essence of a planned economy of the socialistic or communistic type. We have repeatedly pointed out certain advantages claimed for free enterprise and need not repeat them here. What then, in a free economy, is the basis for such government operation as we have?


PUBLIC HOUSING
IMPROVED EDUCATIONAL FACILITIES
MEDICAL CARE
SOIL CONSERVATION
ESSENTIAL TRANSPORTATION

GOVERNMENT "INTERFERENCE" NEED NOT BE NEGATIVE. (Reproduced from "The American Way—Business Freedom or Government Control," by Maxwell S. Stewart, courtesy of the Public Affairs Committee, Inc., New York.)

The question requires a somewhat lengthy and complicated answer. We must first of all consider that there are certain things that, in their nature, could not be carried on as a profit enterprise. National defense, police and fire protection, and the maintenance of many of the strictly governmental agencies are good examples.

There are some projects, the returns for which are so long deferred that private capital would not be attracted to it. For instance, certain forms of conservation will not reach their full fruition for two or three generations hence.

There are some services that are very desirable both from a social and an individual standpoint but that many people would not buy if they each had to pay a price equivalent to cost plus a reasonable profit. Among these we may list the various educational agencies and institutions for health preservation and social benefit.

The extensive use of certain facilities is of such commercial and social importance that it is deemed best to provide such facilities at public expense and then let people use them as much as they like. The best examples of these are streets, highways, and bridges. These can be operated by private concerns, subject to a toll charge for use; in fact, some bridges are so operated. However, if toll charges on highways were universal, traffic would be greatly delayed and hampered.

Finally we have public charity. Charity of course cannot be carried on by private business on a profit basis. Part of the work of public charity is carried on by private organizations, and part by the government. Private charity is by no means unimportant. A partial list of these agencies and institutions are churches, hospitals, Red Cross, Community Chests, Salvation Army, labor unions, endowed clinics, and various other more specialized organizations. Much, however, is still left for the government to do. Among the important charity work by the various governmental units are general hospitals; public health departments; institutions for the blind, deaf, and other unfortunates; and various agencies for taking care of destitute persons who are not otherwise provided for.

Running through most of the situations mentioned above we note the emphasis upon the broad social good rather than, necessarily, upon the desires of each particular individual. If we want to be sure to avoid a clash with free enterprise, production for use should perhaps not go far beyond this. When it does, we are perhaps approaching the socialistic state.

A PARTIAL CHARGE IS MADE FOR SOME SERVICES

In an earlier section of this chapter we learned that some services require a partial charge, and that others are entirely free. We also found that some services apply to society as a whole in a general way. Others are a matter of private choice, and still a few others are compulsory. Each of these types of services will now be briefly considered.

The government charges for the use of the postal system and collects a fee for numerous other services. Some of the public officials are partly paid through the collection of fees. Attendance at state colleges and universities usually involves the payment of tuition. With the possible exception of the postal department, toll bridges, and certain publicly owned utilities, few of these public enterprises even approach paying all their expenses by collections taken in from individuals using these services.

MOST SERVICES ARE FREE

Government services that result in benefits to the public in general, such as army, navy, and police protection are, by their nature, precluded from paying their way. The same is true of the development and conservation of natural resources. Public education could levy a partial charge upon individuals using such facilities, but in practice it is seldom done except on the collegiate level. The theory is that a reasonably high level of popular education is so essential to the preservation of representative government that we cannot take a chance at excluding anyone from its benefits.

Streets and highways are usually offered free of charge. The social and economic advantages of so doing have already been mentioned.

SOME SERVICES APPLY TO SOCIETY IN GENERAL

We have indicated that there are some services that are a matter of private choice. We can take them or leave them. If we exclude ourselves from these services, they are of no direct benefit to us. A closely knit web of paved highways is of no direct interest to one who never uses them. This does not mean that the highways do not provide him with incidental benefits, but he can refuse the specific and personal benefits as much as he likes.

There are, however, some types of services that are ours without any act on the part of most of us. They simply apply to society as a whole. The best example of this is national defense. The same is largely true of police protection, fire protection, and the general operation of our government as such.

A FEW SERVICES ARE COMPULSORY

Some services are not only free but are forced upon us for the public good. The best example of this is our compulsory laws regarding public education. Certain health services such as vaccination and physical examination of school children also come under this heading.

It may seem strange that anything obviously for the individual's good should be forced upon him. The fact is that many people fail to realize the importance of such benefits. Others do not like the inconvenience and sacrifice of their freedom that the acceptance of such free services might entail. When doing good to a considerable number of people is essential to the welfare of society and when there is a likelihood that some would refuse, compulsion must be applied.

SUMMARY

By production for use we mean primarily the performance of certain government services financed wholly or largely through public taxations. This may be contrasted with production for profit, which incidentally results in effective production of desirable commodities and services.

The portion of our needs supplied by the government is considerable. Insofar as it can be measured in money terms, it is not far from one-fourth of the total. Many of these services apply to society as a whole and cannot be considered in terms of individual use. Others are left to the choice of individuals, and these may be either free or be subject to a partial charge.

Government services in our country are largely confined to fields where important social factors are involved. When the government goes beyond this limit in producing for use, it encroaches upon free private enterprise and approaches socialism.

QUESTIONS FOR REVIEW

1. What is meant by the term *production for use?*
2. Why is it that we frequently do not realize the full extent of present production for use?
3. What portion of our national income is spent for governmental services? Name ten things that an average family gets in return for this.
4. In determining the reasonable limit of production for use, name several important factors that should be considered.
5. For what types of service is a partial charge often made?
6. Mention some types of service that are entirely free to the public.
7. Mention some types of service that apply to society in general rather than to individuals.
8. Point out some types of service that are made compulsory.

QUESTIONS FOR DISCUSSION

1. If we materially increase the amount of production for use, what effect will this have on production for profit? Will this mean a loss of some portion of our present free-enterprise system?
2. If we supplied 80 per cent of our needs from governmental services and 20 per cent from private business, do you think the total received would be greater or less than it is at present?
3. Why is partial tuition cost for an education in a state college paid by the student? Do you think such tuition should be free?

CASE PROBLEMS

1. The recreation committee of the Fairview Chamber of Commerce reports that additional recreational facilities are needed for the young people of Fairview and vicinity. The board of directors of the Fairview Chamber of Commerce is discussing the question of whether the city council should be requested to levy an additional tax to provide the needed facilities. What are some of the factors that should be given consideration in the discussion?
2. A group of parents in the town of Explora sent a petition to the local school board asking that a new school building be erected. Many other citizens of the town have objected, pointing out that this would cause a substantial increase in taxes. How can the school board decide what to do?

SUGGESTED PROJECTS

1. Check through catalogues of various colleges, being sure to include some from various sections of the country, and compare the tuition charges of various state colleges and of various privately operated or church colleges.
2. Investigate and report on the extent to which modern socialism would advocate "production for use."

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24. Paying the bill

PREVIEW: Government financing by means of taxation is a cooperative method of providing goods and services essential to the general welfare. Public finance is closely related to business activity and public welfare. Methods of providing the money are the concern of all. What is a good system of taxation? What are the different kinds of taxes in this country?

THE MONEY MUST COME FROM SOMEWHERE

Since only an insignificant fraction of the cost of government is paid by people directly receiving specific government products, property, and services, the bulk of the required money must come from taxation. Of course money may be borrowed, but, since borrowings are subject to repayment out of tax receipts, we may say that taxes constitute the only ultimate source for the payment of free government services.

In Chapter 23 we enumerated the many benefits that individuals and society as a whole receive from the government. Most good things are purchased at a price. The blessings of a good government are no exception.

THERE IS NO PERFECT TAX

Financing the government through taxation is a complex problem, and it is further complicated by our numerous forms of taxation. Perhaps no one claims that our taxing system as a whole is very well planned. In fact one is tempted to believe that there is no over-all planning whatever. Some forms of taxation are bad; some are defensible; none are perfect:

There are several reasons why our taxing system is not closer to perfection than it is. Some of these reasons are as follows:

1. The historical reason. There is a tendency for a tax to continue after it has outlived its usefulness. For example, many people claim there is no longer any justification for the high taxes on real property.
2. Efforts to find a *painless* tax. Some tax methods are admittedly inefficient but have the dubious advantage of not being felt so keenly by the taxpayer. This applies especially to taxes on imports and some other forms of indirect taxation.
3. Belief that a variety of taxes is best. The assumption is that if an individual is unfairly taxed by one method, it is compensated by some other method that turns out to his advantage.
4. Lack of coordination among the Federal, state, and local taxing units.
5. The tendency to seize practically every available opportunity to collect at least a small amount of revenue. As the saying goes, "Whenever you see a thing, tax it."

The exercise of these various views has not been conducive to the building of a scientific, equitable, and adequate taxing system. There is a danger that, even if we could devise a well-nigh perfect system of taxation, such a plan would not be entirely able to pass the hurdle of political expediency.

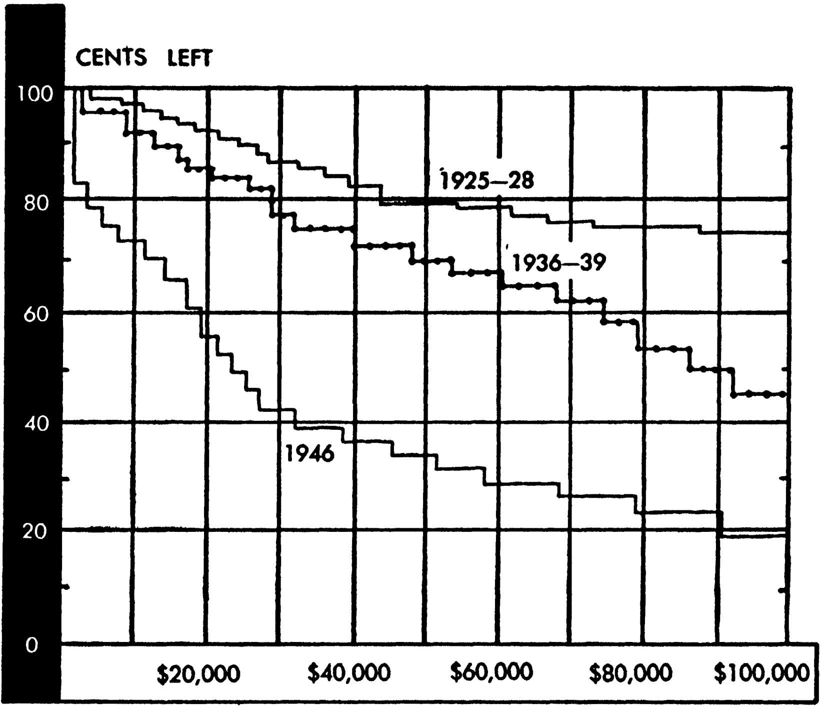
WHAT IS A GOOD TAXING SYSTEM?

An ideal taxing system would be one that is inexpensive to operate and that would apportion the taxes with perfect fairness to each individual. How to bring this about is the crux of the whole question and is by no means an easy thing to accomplish. The following are some of the important elements of a good taxing plan:

1. Taxes should be levied on the basis of ability to pay.
2. They should not be destructive to legitimate private enterprise.
3. They should not be easy to pass on to others.

4. They should not be easy to evade.
5. They should be easy to collect.

Perhaps the basic emphasis should be placed on the first two of the above points. People should pay according to ability, but this should not be carried so far that it destroys private enterprise. According to ability does not mean pro rata. A person with an income of $1,000 a year may find even a 5 per cent tax, or $50, quite a burden. On the other hand a 25 per cent tax, or $25,000, would not be unreasonable on an income of $100,000. This is known as the *graduated principle*—the rate gradually increasing with the increase in income. The usefulness of this graduated principle ceases when the rate becomes so high that the individual has little or no inducement for attempting to increase his income.



CENTS LEFT TO TAXPAYER OUT OF EXTRA DOLLAR'S EARNINGS. (Monthly Letter of National City Bank, New York, March, 1947.)

The next three points are easily understood. It is well known that many taxes are not much of a burden upon the man who pays them, since he can pass them on in the form of higher prices. Illustrations of this are the sales tax, excise taxes, and duties on imports. The question as to who eventually shoulders the tax is known as the *incidence* of taxation. Not only may some taxes be passed on to others, but they may be largely evaded by unscrupulous taxpayers. This, for instance, may take the form of concealment of income or property to be taxed. The final test of a good tax is that it should involve an easy and inexpensive method of collection.

NEARLY ALL TAXES PARTLY PAID BY CONSUMERS

Nearly all taxes ultimately fall on the consumers, at least in part. Sometimes this takes place in a roundabout way, and it may take some time before an increase in certain kinds of taxes is felt by purchasers of goods and services. This is especially true of real-estate taxes and the income tax.

In a certain town the rent for a typical house is $50 a month. There is an increase of taxation amounting to the equivalent of $5 a month on this kind of property. If houses are plentiful, the rent may continue for a while at $50, during which time the taxpayer bears the burden. However, high taxes discourage new construction, and after a while a housing shortage develops. When this happens, the renters may be fortunate if they do not have to pay even more than $55. If the extra tax occurred during a housing shortage, the increase in rent would probably come as soon as existing leases expired. We are of course assuming here that there is no legislation regarding maximum rents.

The income tax works out somewhat the same way as property tax. This is especially true with respect to income taxes on corporations. Whether we call it so or not, corporation income taxes are generally looked upon as a business expense. Increased expenses represent increased cost of production, and increased cost of production eventually tends toward increased prices. Again the consumer finally bears either all or a large part of the burden.

The manner in which personal income taxes finally reach the consumer can best be shown by an illustration. A corporation official was getting $50,000 a year on which he paid a 30 per cent tax, or $15,000, leaving him $35,000. A law is passed under which he would have to pay 70 per cent on $50,000. He feels entitled to and will likely receive a pay increase. But as the pay increases, the tax rate also increases. The result is that, to give him $35,000 net, the salary may have to be increased to $200,000. Again we have an increase in production cost followed by an increase in prices—once more the consumer foots the bill.

THERE ARE MANY KINDS OF TAXES

The many conflicting views and practices have given rise to a considerable variety of taxes. Most of these have certain good features, but none has a combination of all the advantages. Some of the important forms of taxation are

1. Property taxes. Levied in proportion to assessed value of property owned. Levied chiefly on real property.
2. Income tax. Based on income at a graduated rate. Inheritance taxes, gift taxes, etc., are very much the same type.
3. Direct sales tax. Levied directly on sales and paid by the purchaser.
4. Excise taxes. Taxes on particular commodities and services. Different from sales tax in that the buyer does not *specifically* pay the tax. Usually, however, the buyer *does* pay the tax in the form of a higher price. Examples of such taxes are those paid by the producers of tobacco products and various beverages.
5. Duties on imports. Tax on goods imported.
6. Poll tax. A flat tax per individual, sometimes referred to as a *head* tax.

It will be noted that some of the taxes cannot be escaped by anyone who buys something. Sales taxes, excises, and import duties come under this heading. A person pays no property tax unless he has taxable property, and very small incomes are exempt from income tax. However, it is certain that even a person who is not directly responsible for such taxes nevertheless pays a portion of them in the form of higher prices.

The poll tax is an item of small and decreasing importance in our taxing system.

SOMETHING IN FAVOR OF MOST TAXES

There is no person so bad that nothing good can be said about him. The same can be said about the various kinds of taxes. Measured in terms of a good taxing system, we shall now consider each type of tax in turn.

Property taxes. These taxes, especially on real property, are not easy to evade and are easy to collect. They are not especially easy to pass on to others except, to some extent, in connection with rented property. Unless excessive they will not destroy private enterprise. The great defect in this kind of a tax is that ownership of property is frequently a poor indication of ability to pay. There is such a thing as being "property poor." This is especially true if the property is heavily mortgaged. Furthermore there is frequently a tendency to overassess old property.

Income tax. This comes closest to being an ideal tax and is rapidly growing in importance. It comes the closest of any plan to levying taxes on the basis of actual ability to pay, and, especially in the case of personal income tax, it is difficult to shift all the tax to others. Income taxes are becoming increasingly difficult to evade, and collection is not exceptionally difficult. There is a constant danger that the tax on large incomes may be set at a rate so high that it will seriously hamper business enterprise. There is little inducement to enter upon a business involving considerable risks if the enterprising person knows that if he does succeed he must turn over the bulk of his earnings to the government. On the other hand, to impose too much of a tax burden on the low-income group is also undesirable.

Direct sales tax. This tax has all the good features except one; *i.e.*, it does not equitably distribute the tax burden (but this one quality it lacks to a high degree). In fact, the poor pay proportionately more than the rich, since they generally spend a larger portion of their income on goods subject to the tax. This objection is so serious that, except in case of an emergency, many authorities contend that sales taxes should be kept down to a low figure or eliminated entirely.

Excise taxes and duties. These taxes are somewhat similar in nature and both are subject to the same objections. They do have certain good points, but they are not apportioned on the basis of ability to pay, and they are easily shifted to the consumer in an augmented form. The chief reason why they are maintained is that they are relatively *painless.* The consumers, who really pay these taxes, are not aware of the extent to which they are paying. Taxes that consumers pay indirectly are sometimes known as *hidden* taxes.

A poll tax, or other per capita tax, is entirely wrong in principle, since it pays no attention whatever to relative ability to pay. Such tax levied in small amounts may do but little harm. As a matter of fact the amount collected from poll taxes is relatively small. The only good argument in favor of poll taxes is that they bring in a little money from people who would not otherwise pay any direct tax.

TAXES SHOULD NOT OVERLAP

There may be said to be three taxing units. These are the Federal, the state, and the local governments. It would seem desirable that, insofar as possible, each of these should have certain fields of their own within which to collect its revenues. For instance, the Federal government might rely upon income taxes, duties, and excises; states should have sales taxes on goods other than basic necessities

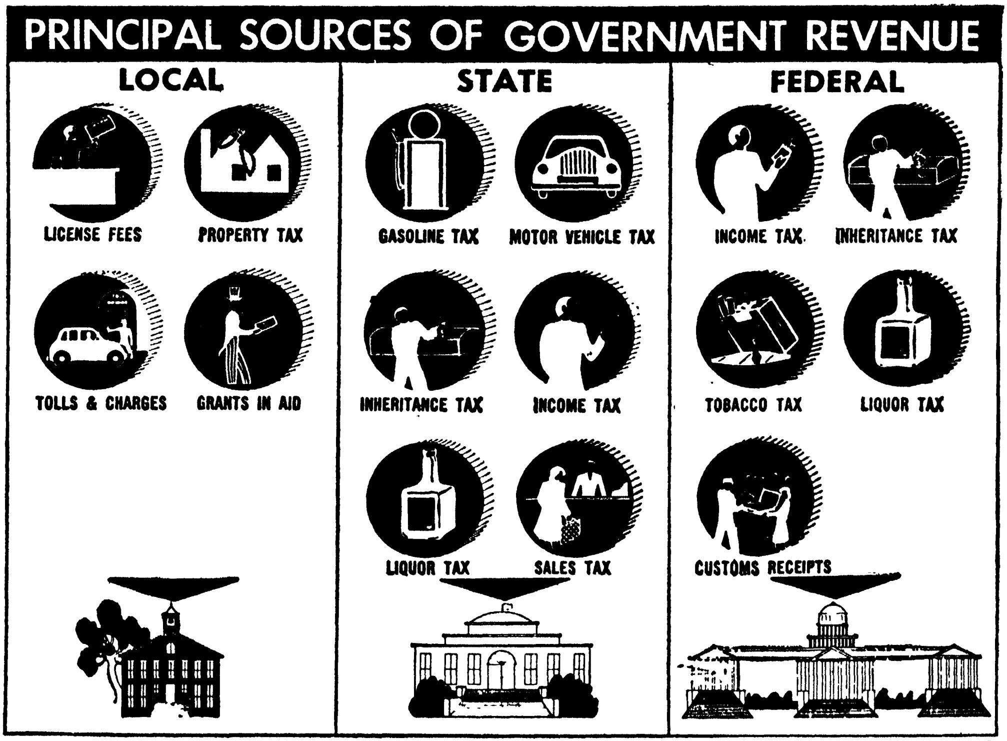

PRINCIPAL SOURCES OF GOVERNMENT REVENUE
LOCAL
LICENSE FEES
PROPERTY TAX
TOLLS & CHARGES
GRANTS IN AID
STATE
GASOLINE TAX
MOTOR VEHICLE TAX
INHERITANCE TAX
INCOME TAX
LIQUOR TAX
SALES TAX
FEDERAL
INCOME TAX
INHERITANCE TAX
TOBACCO TAX
LIQUOR TAX
CUSTOMS RECEIPTS

CHART BY GRAPHICS INSTITUTE, N.Y.C.

together with small levies upon real property. Local governments should be allowed to collect the bulk of the taxes on real property supplemented by local licenses and other business taxes.

As a matter of fact, taxes are divided largely upon the basis of the plan mentioned. The chief violations of the rule consist of income-tax levies by the states and some sales taxes by the Federal government. Such duplications are confusing and tend to place too large a tax burden upon particular individuals.

INFLATION IS INDIRECT TAXATION

Sometimes the Federal government will finance itself partly by the issue of nonredeemable paper money or by selling bonds on the basis of inflated bank credit. We shall not go into the intricacies of the problem but shall merely make a bare statement of fact as to just what happens when this is done.

If the government wants to buy 1 billion dollars of commodities in the market it can, if it wishes, print 1 billion dollars' worth of paper money to pay for it. So far all is well. Essentially, the government paid nothing. People did not have to pay taxes. No one had to save and lend the money to the government.

The trouble is that the end is not yet. The government takes 1 billion dollars worth of goods out of the market, reducing the total available by that amount. At the same time the 1 billion dollars of new money trickles down to the general public. Simultaneously there is a relative shortage of available goods. It does not take a highly trained economist to see what happens. Shortages of goods and abundance of money spell high prices. Instead of paying direct taxes you pay taxes in the form of higher prices for everything you buy. It is strange, but true, that many people who would almost rebel at a 10 per cent sales tax take an equal increase in the cost of living with relative complacency.

Remember—no matter how the government finances an expenditure, we, the people, eventually pay the bill in full.

BORROWING OUT OF SAVINGS NOT INFLATIONARY

If people save money and lend their savings to the government, no inflation results. This can be shown by means of an illustration based upon somewhat the same facts as those presented in the previous section.

Once more let us suppose that the government wants to buy 1 billion dollars' worth of commodities, but this time it borrows out of savings. People reduce their purchases of commodities, by reason of their savings, precisely to the extent that the government buys commodities with their savings. Available goods are reduced by 1 billion dollars; but purchasing power in the hands of the people is also reduced by 1 billion dollars. There is thus no change in the ratio. Prices remain constant. It may be a painful method, temporarily. But it is safe and sound.

SUMMARY

Taxes of various kinds are the only ultimate method of paying the major portion of the expenses of government. Borrowing is only a temporary expedient. Inflation is a hidden form of taxation.

A good tax should be levied on the basis of ability to pay and should not be destructive to private enterprise. In addition to this a tax should be easily collected and not readily evaded. Finally we should place the burden of the tax where we aim to place it. The tax should not be of such a nature that it can be largely or wholly shifted to those who are not supposed to pay it.

There are many kinds of taxes. The most important are the property tax, income tax, direct sales tax, excise taxes, duties, and poll tax. Each of these taxes has certain advantages. None has all the good points. The perfect tax has not yet been devised.

QUESTIONS FOR REVIEW

1. Ultimately, how must we pay for "free" government services?
2. What are some of the reasons why our tax system is not perfect?
3. What is a good taxing system? What are some of the elements that go to make up such a system?
4. Which are perhaps the most important elements to consider in a perfect system?
5. What is meant by the "incidence" of taxation?
6. Name, describe, and evaluate the six main types of taxes.
7. In what ways do taxes often overlap?

8. Mention a possible division of fields of taxation among the three main taxing units.
9. Explain how inflation is in a way an indirect taxation.
10. Why is it that borrowing out of savings is not inflationary?

TERMS AND PHRASES TO DEFINE OR EXPLAIN

1. Taxation
2. Ability to pay
3. Income tax
4. Duties on imports
5. Perfect tax
6. Incidence of taxation
7. Direct sales tax
8. Poll tax
9. Painless tax
10. Property tax
11. Excise tax
12. Head tax

QUESTIONS FOR DISCUSSION

1. Who, if anyone, would be dissatisfied if we had but one form of taxation for revenue purposes, namely, the income tax?
2. Why is it that the property tax is depended upon to such an extent?
3. What possible advantages can you see to continuing the poll tax?
4. For what possible reason other than the raising of revenue may we have duties imposed on various imports?
5. Why do we have overlapping taxes?
6. Although inflation brings many individual hardships and inequities, it also brings higher *monetary* wages and incomes to many people. Hence it is sometimes said that people *like* inflation. What do you think about this?

CASE PROBLEM

A certain corporation had gradually expanded until it found itself doing business in a number of states. It eventually found that it must hire a full-time tax expert to keep it out of tax difficulties and to make sure that it was not paying out unnecessarily large amounts in taxes. This expert finally, after studying the financial statements and records of the company, recommended that it disband as a single corporation chartered by one state and instead take out charters in three different states—of course properly and legally interrelated. He showed how this would mean an annual saving of over 1 million dollars to the company in taxes. How might this saving be accounted for?

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Unit Nine • BUSINESS LOOKS AHEAD

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25. The business cycle

PREVIEW: One phenomenon of the capitalistic system that perhaps cannot be entirely eliminated is *the business cycle.* This refers to the observed fact that business as a whole never goes forward in a straight line but is continually fluctuating in its volume and profitableness. The essence of this situation is that production never goes forward at an even keel close to maximum production but fluctuates all the way from close to the top to as low as 60 per cent of maximal output during periods of prosperity. The business cycle swings with painful regularity and passes through four stages—depression, recovery, prosperity, and decline. From the decline we again pass into depression, and the process is repeated. What are some of the causes of the business cycle? What are some of the suggested remedies?

NOTHING MYSTERIOUS ABOUT BUSINESS CYCLE

The phase of the business cycle about which we are especially concerned in the present discussion is that of depression. Some people look upon a depression as something mysterious—something like a strange epidemic that falls upon a community from we know not whence. Such people will also say that there is no way really to determine the causes of these maladjustments, and hence there is no possibility of an effective cure.

The fact of the matter is that bad times for a nation are not any different from business reverses for an individual. If one important business individual fails in a small community, there may for some time be rather hard times in that community. If a million business firms are depressed or fail, we are in a depression of national scope and demoralizing intensity.

A national, or even a world-wide, depression is nothing but the compound result of the failure of a great number of business firms and individuals.

BUT WHAT IS BACK OF ALL THIS?

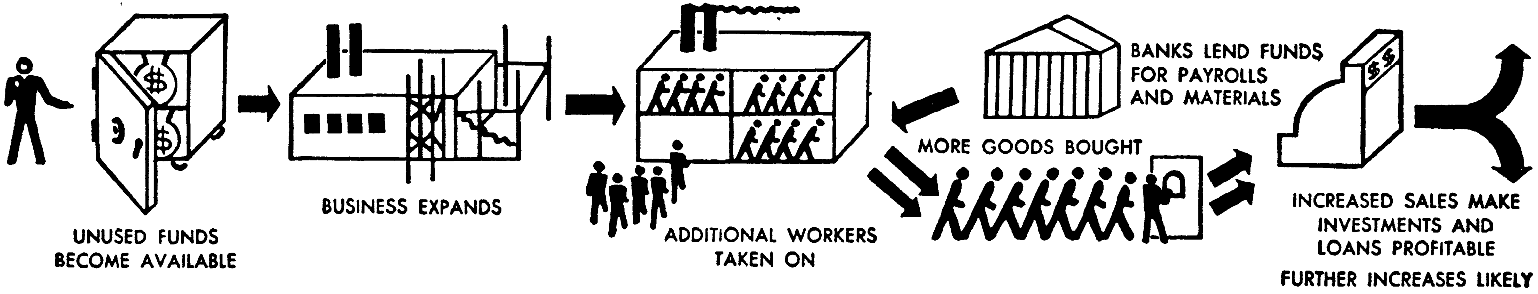
There are many basic and specific reasons for periodic depressions, but the immediate cause is that a considerable number of people are financially *compelled* to close their business, or at least do not find it profitable to continue. Business is conducted for profit. If it is profitable for any given individual to expand production, production will be expanded. If it is more profitable for him either to contract his business or close down entirely, he will act accordingly. When a sufficient number of people simultaneously decide upon the latter course, we have a major depression.

Since profitable operation is essential to the continuance of business, one might draw the conclusion that all we need do is to maintain universal and exorbitant profit and all would forever be well with our economic system. Such reasoning is fallacious. High profits will create good business while they last—but they will not last. As we shall see later, exorbitant profits carry within themselves the germs of future depression. The most wholesome situation, insofar as the business cycle is concerned, is one in which all reasonably efficient producers are at least making the *full* cost of production and where the prospects are good that this reasonably happy condition will continue.

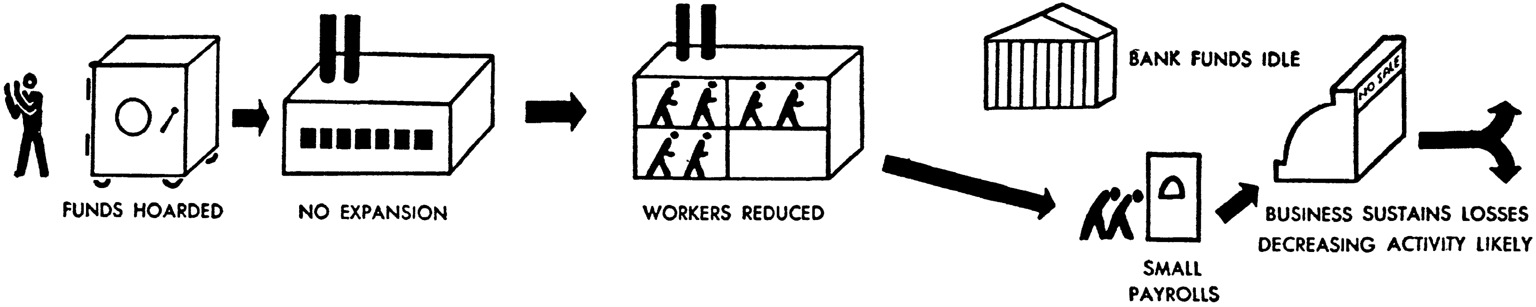
WHAT ARE SOME SPECIFIC AND BASIC CAUSES?

Having explained that depressions occur whenever a number of businesses find it unprofitable to produce, we are ready to consider some specific reasons for such unprofitableness. We shall first examine some of the causes advanced by various economists and shall then briefly examine each in turn. The validity of each of the

GOOD BUSINESS PROSPECTS MAKE FOR GOOD BUSINESS


UNUSED FUNDS BECOME AVAILABLE
BUSINESS EXPANDS
ADDITIONAL WORKERS TAKEN ON
MORE GOODS BOUGHT
BANKS LEND FUNDS FOR PAYROLLS AND MATERIALS
INCREASED SALES MAKE INVESTMENTS AND LOANS PROFITABLE
FURTHER INCREASES LIKELY

POOR BUSINESS PROSPECTS MAKE FOR POOR BUSINESS


FUNDS HOARDED
NO EXPANSION
WORKERS REDUCED
BANK FUNDS IDLE
SMALL PAYROLLS
NO SALE
BUSINESS SUSTAINS LOSSES
DECREASING ACTIVITY LIKELY

(Reproduced from "How Money Works," courtesy of the Public Affairs Committee, Inc., New York.)

causes mentioned will be left to the judgment of the student. The most commonly mentioned causes are

1. The unwillingness or inability of business to adjust itself speedily to changing price situations
2. The psychological fluctuations between fear and optimism
3. Overexpansion coupled with underconsumption
4. Too much borrowing
5. Currency and credit inflation
6. Self-generation of the various phases of the business cycle
7. Tendency toward cumulative effects

In the case of some of the suggested causes it will be readily understood that they would have appreciable effect upon the course of business. The effect of others is not quite so obvious.

FAILURE OF ADJUSTMENTS AN IMPORTANT CAUSE

Our economic system is supposed to move forward on the basis of demand and supply automatically adjusted by the price system. If this system always operated smoothly and without fail, there would be no depressions. We may therefore say that this failure of adjustments is the most *fundamental* cause of business depressions.

In previous chapters we have at different times pointed out the existence of this tendency toward maladjustments. Rather than repeat what we have said, we shall give a concrete and typical example drawn from a situation that may well occur.

Let us suppose that there has been a boom in the building industry with high wages, plentiful employment, and big profits for materialmen and contractors. Demand for building slackens. Is there an immediate price adjustment to the situation? Usually not. Materialmen all along the line are reluctant to reduce prices, partly caused by the unwillingness of their workers to take lower wages. Contractors refuse to lower their margin of profits; building workers will be idle rather than to take lower wages. The results are loss of profits because of small volume of business, insolvencies because of failure to meet current obligations, and unemployment because of unwillingness to adjust wages to meet the decreased demand.

Now what would have been the cure for this situation? Did the slackened demand for buildings mean that people did not want any more buildings? No, but they did not want buildings at existing prices. Reduce prices sufficiently and promptly and the good work would go on. But the adjustment would have to be made all along the line. Everybody would have to take less in order to avoid getting nothing at all.

IS IT A MATTER OF PSYCHOLOGY?

Some people talk as if depression and prosperity are purely a matter of psychology. This perhaps is an exaggeration. Certainly these recurring phenomena are not entirely caused by alternating fear and optimism of an unreasoning nature. Usually there is rational basis for the various emotions. At the inception of a depression other causes come first. From that point on, fear is an important aggravating factor.

THEN WE HAVE OVEREXPANSION AND UNDERCONSUMPTION

A certain group of economic writers has played up *underconsumption* as a cause of business depressions largely to the exclusion of all other possible causes. The reasoning goes something like this: A few people get so much of the total national income that they are compelled to save the major portion of it, thus depriving others of income that would be spent for consumers' goods if they had it. The result is that there is a constant tendency toward expanding production facilities to a point where profitable markets cannot be found for the goods produced. When this point is reached, expansion stops, production is reduced, *a depression is on.*

This theory has a high degree of plausibility. Certainly it is a condition that conceivably could exist. If most people just wanted to save and invest and nobody wanted to buy anything but the bare necessities of life, economic trouble would certainly soon ensue. This of course is an admittedly unrealistic exaggeration of the actual situation, used merely to emphasize the point. The extent to which so-called *oversaving* and *underconsumption* take place to the point of causing depressions is not fully known.

HE WHO BORROWS WILL SOMETIMES BE SORRY

We have in previous connections pointed out the danger of operating a business on a *thin equity.* The sad part about a debt is that interest must be met, and the principal must be paid at maturity if the business is to remain solvent. This is easy while sales are large and profits are good. When business adversity comes, a heavy indebtedness becomes an important factor in making the future operation of the business difficult if not impossible.

That which is true of the individual business concern is true of business as a whole. In the great depression of the thirties the businesses, large and small, that survived were chiefly those with little or no indebtedness. The combined effect of the many insolvencies due to excessive creditor obligations was an important contributing factor toward deepening the extent of the depression.

TOO MUCH MONEY

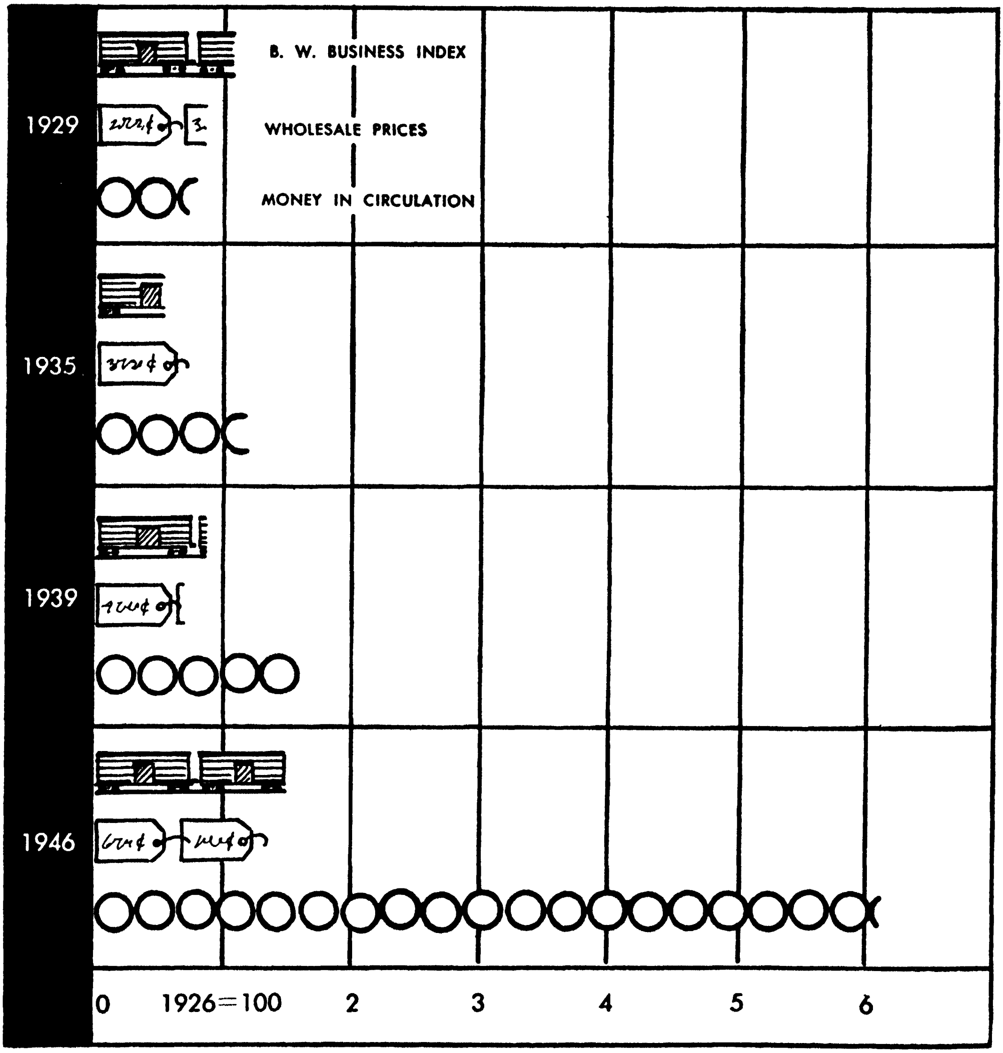
We have previously explained what is meant by inflation. The depression does not come while the inflation lasts. It comes when the inflation stops. An inflation *must* stop somewhere or prices will rise to such heights that money becomes worthless. It is seldom that inflation reaches such heights. Before that time comes, buyers begin rebelling against the high prices, banks become worried and call in their loans, holders of securities begin to unload because of fear of further price declines. Prices decline rapidly. A panic develops. Depression follows.

IS THE BUSINESS CYCLE SELF-GENERATING?

The statement that one phase of the business cycle generates the next phase is to some extent nothing but a summarization of much of what has already been said. However, this theory stresses the inevitableness of the cycle, and those who emphasize this view frequently recommend something approaching a hands-off policy. For instance, they claim the depression is merely a natural correction of an unsound condition. Efforts to mitigate its effect, except for measures to prevent wholesale destitution, will merely prolong the agony.

This view has many elements of truth and is well worthy of study. As a depression runs its course, debts will be liquidated through insolvencies, and the credit situation is thus improved; prices go down, offering good inducement to buyers; old stocks are

PRICES, PRODUCTION, AND MONEY



(Data furnished by "Business Week.")

sold out, thus encouraging production for replacements; building has been at a standstill so long that construction work is needed; wages have gone down to a sufficiently low point; recovery has begun.

As business advances, prices again begin to rise. Bank loans are easy to acquire. Wages go up. Work becomes plentiful. Profits are good. Business is expanded. Inventories are accumulated. This is the period of prosperity.

An examination of the elements composing prosperity will reveal that they carry with them the causes of an invariable decline and ultimate depression. After a while it will be found that inventories are too large. Prices fall. Profits begin to disappear. There is no inducement for further expansion. Laborers resist wage decreases. Banks call in their loans. Insolvencies multiply. We now again have all the earmarks of a real depression.

THE EFFECTS ARE CUMULATIVE

When a certain tendency is once set in motion, it tends to increase on its own momentum. For instance, if a number of people lose their jobs, the market for goods is diminished, and there is a further cut in production resulting in still greater unemployment. Thus the process goes on. The solution for this would seem to be to nip the process in the bud before it has progressed too far. That which is true of unemployment is also equally true of other symptoms of an impending depression.

THE CAUSES SUGGEST THE REMEDY

As we mentioned the various causes of depression we gave some indication of the remedies. We shall now list these proposed remedies in the same order in which we enumerated the causes.

1. Speed up the price adjustments to changing conditions. This can be accomplished partly by elimination of monopolistic conditions but must depend chiefly upon the broad-mindedness and good sense of every businessman and laborer.
2. Avoid overoptimism and undue pessimism and fear. This is partly a matter of proper education but chiefly a matter of removing as many as possible of the economic causes for such emotions.
3. Provide a better balance between production and consumption of consumer goods. Avoid overexpansion of producing facilities. This ties up with the oversaving and underconsumption theory we have already discussed.

4. Do not overborrow. Laws restricting borrowing can be introduced, but the best safeguard is the good sense of each borrower or lender.
5. Avoid an era of easy money. This refers to our frequently discussed topic of inflation.
6. Try in every way to avoid unbridled prosperity because this type of prosperity will surely lead to depression. Here again our chief concern is to prevent inflation.
7. Apply all desirable remedies before the cumulative effects of maladjustments get into full play.

SUMMARY

The fluctuating nature of our business called the *business cycle* is perhaps the most serious defect in our economic system. The immediate cause is the inability of a large number of concerns to continue profitable operation. Back of this there are many basic causes. Some of the most important of these causes are failure of proper business adjustments, psychological factors, overexpansion, underconsumption, too much borrowing, and inflation.

There is much to indicate that the various phases of the cycle are largely self-generating, and there is a tendency for any maladjustment to increase in intensity when it is once well under way.

QUESTIONS FOR REVIEW

1. What are the four main stages of a business cycle?
2. In what way may a national depression be said to be related to the failure of one or more individuals or individual firms?
3. Would it be desirable to maintain exorbitant profits indefinitely?
4. Mention a half dozen recognized specific and basic causes of the business cycle.
5. Illustrate how failure to adjust demand and supply through the price system is a contributory cause of the business cycle.
6. To what extent is psychology the cause of the business cycle?
7. To what extent may overexpansion or underconsumption be a basic cause?
8. How may borrowings be a contributory factor?
9. What is meant when some say it is caused by too much money?

10. Explain how a depression and a period of prosperity may each be but a correction of an unsound business condition.
11. Mention a half dozen or so remedies that may be worth consideration.

TERMS AND PHRASES TO DEFINE OR EXPLAIN

1. Business cycle
2. Recovery
3. Full cost of production
4. Oversaving
5. Insolvency
6. Prosperity
7. Decline
8. Overexpansion
9. Thin equity
10. Depression
11. Maladjustments
12. Underconsumption
13. Too much money

QUESTIONS FOR DISCUSSION

1. Are underconsumption and oversaving really the same thing? If so, which term do you think more accurately describes the situation?
2. Just how important do you think economic education is in any attempt to overcome the business cycle and still maintain our present economic system?
3. Does everyone profit from a period of prosperity and everyone lose from a period of depression?
4. What would be some illustrations of the effects of psychology on the tendency toward continuation of the business cycle?
5. In approximately which phase of the business cycle do you think this country is at the present time?
6. What effect may a world war have on the development of the business cycle?
7. What are some of those factors that, at one stage of the business cycle, are likely to cause overoptimism?

CASE PROBLEM

Jack Shelton, a veteran, graduated from college in the spring of 1947. He had majored in commerce. He has $5,000 saved and plans to start his own small retail business. Some friends advised him to wait before starting in business for himself, stating that the present high prices would doom his business to failure eventually. Others advised him to get started immediately. What would your advice probably have been?

SUGGESTED PROJECTS

1. Using a full sheet of paper, draw up a circular chart summarizing various characteristics of different phases of the business cycle. Indicate PROSPERITY at the top of the circle, DEPRESSION at the bottom, DECLINE at the right hand side, and RECOVERY at the left-hand side. Then in some appropriate arrangement indicate typical characteristics of each of these four phases.
2. Bring to class specific illustrations of either high or low prices actually charged for various commodities (eggs, shoes, corn, beefsteak, etc.) at various times in the history of the United States. Be able to indicate the approximate year applicable. (Consult various books on economics, prices, business cycles, economic history, etc., or encyclopedias, or files of old newspapers, etc.)
3. Check through recent numbers of the following magazines and papers and report to class the nature of information found in each relating to the business cycle.
   - *a. American Economic Review*
   - *b. Economist*
   - *c. Consumers Guide*
   - *d. Journal of Economic History*

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26. Other undesirable outcomes of the capitalistic system

PREVIEW: Few will insist that our present capitalistic free-enterprise system is a perfect one. Before any business system can be improved, it is essential to know something about the defects. In Chapter 25 the problem of the business cycle was discussed. What are some of the other undesirable outcomes of the capitalistic system? What are some of the proposed remedies?

WHAT ARE SOME BASIC DIFFICULTIES?

In Chapter 25 we outlined what is perhaps the chief defect of the capitalistic system—the tendency of business to work up toward a period of almost feverish activity and then relapse into another period of business depression. Starvation in the midst of abundance, and unemployment with idle mills ready to be used are the paradoxes of the modern economic society.

There are a number of other situations that call for certain regulative or directive action. We shall consider a few of these in the present chapter and shall then proceed to investigate what may be done about these conditions. Some of the basic difficulties are

1. Tendency toward monopoly
2. Tendency toward dishonesty and unfair trade practices
3. Inequality in bargaining power
4. Lack of financial security for the individual

5. The general failure of business always to seek socially desirable ends
6. Inequitable distribution of wealth

It cannot be successfully denied that these conditions do exist. Each of these will now be explained.

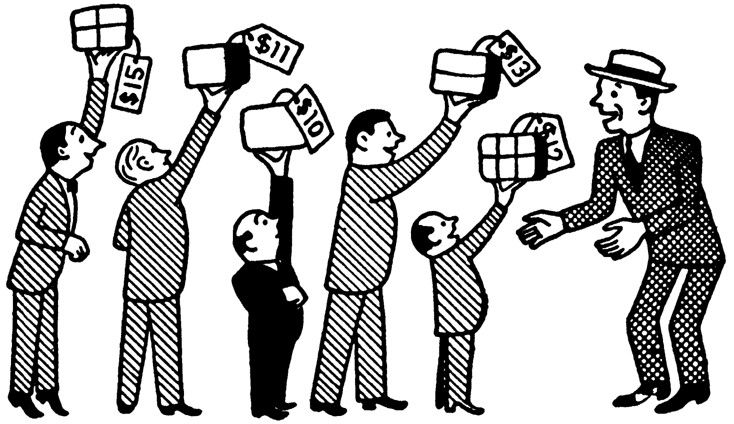
TENDENCY TOWARD MONOPOLY

The theory of capitalistic production and distribution is predicated upon the existence of a considerable degree of competition. By this we do not mean competition of the cutthroat variety where each businessman is out to put all others out of business. "Live and let live" has become the slogan of the better part of our business community today.

But a certain degree of effective competition must be operative, otherwise we would no longer have a free economy. On the contrary our very lives would be dependent upon the whims of a closely knit group of financial autocrats. If such a group controlled *all* production, or at least all *basic* production, and at the same time controlled the government, including the Army and Navy, the rest of the people would be essentially slaves. We might be well-fed and prosperous slaves; we might even be allowed perfect freedom in personal matters, but in all economic matters we would be entirely subject to the master's will.

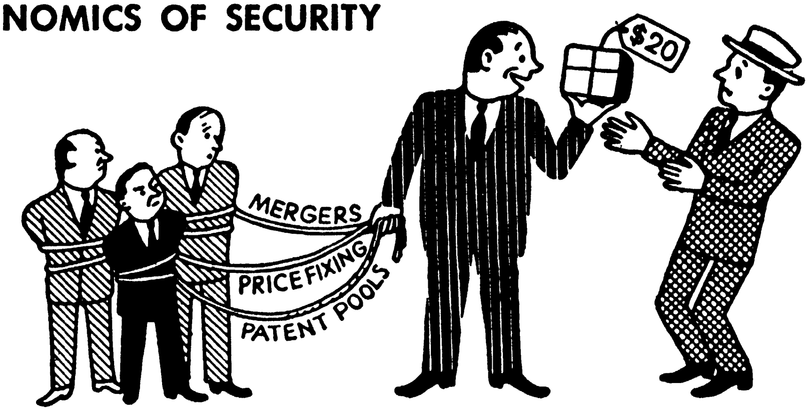
Such an extreme situation has never arisen in this country and probably never will. The contingency, however, is serious, and it behooves us to be on our guard. Unregulated competition begets monopoly. If monopolistic practices once get a good start, it is difficult to stop them. Furthermore even a limited type of monopoly may at times do considerable harm. There are some people who defend monopolies, saying that they save much of the waste of competition and can thus actually lower prices. There may be some truth in this, but experience has shown that monopolies seldom pass on their savings to the public. Rather they charge all that the traffic will bear. Furthermore, absence of competition may lead to inefficiency.

ECONOMICS OF A FREE MARKET



PRODUCERS *CONSUMER*

ECONOMICS OF SECURITY



PRODUCERS *CONSUMER*

WHICH IS THE AMERICAN WAY? (Reproduced from "Cartels or Free Enterprise," by Thurman W. Arnold, courtesy of the Public Affairs Committee, Inc., New York.)

MONOPOLIES NOT EASY TO MAINTAIN

Severe competition is usually costly and frequently destructive for businessmen who take part in it. It is therefore no wonder that they sometimes wish to seek refuge in some more or less monopolistic arrangement. Possibilities of a perfectly successful control of the market are, however, prevented by the following factors:

1. Legislative interference
2. Unless the would-be monopoly is one compact organization, disagreements may develop among the members

3. Constant possibilities of competition
4. Public disfavor
5. The fact that one product is always in competition with all other products

Prevention of monopolies by law will be touched upon in Chapter 27. The other preventive and limiting factors will now be considered.

MONOPOLY NEVER COMPLETE AND UNRESTRAINED

We sometimes hear the expression, "Some people have such control over the market that they can charge whatever they like." Such an assertion is seldom if ever true. Even in the absence of adverse legislation it is difficult to establish any kind of a monopoly. It is practically impossible to maintain unchallenged control permanently.

Competition of some kind cannot be entirely avoided. If it is not existent, it is nearly always potential and may break out at any time. This is especially true if the would-be monopoly grossly abuses its favors. Furthermore it should be remembered that each article placed on the market is to some extent in competition with everything else that is for sale. For instance, if meat were monopolized and prices went up, people would buy less meat and more of other food.

A burglar complained that the chief difficulty in his profession was that it was "hard to get a partner who was honest." Much the same difficulty exists in connection with the maintenance of illegal monopolies. A contract creating a monopoly cannot be enforced. Hence reliance must largely be placed upon the continued cooperativeness of the members of the monopolistic group. An internal breakup is always something of a possibility.

Most business concerns depend upon public favor for their success. Monopolies are in public disrepute. So great is this fear of public censure that most great concerns vigorously object when people claim that they are monopolies. In spite of this and other restraining influences, monopolistic practices do persist and many continue until broken up by legislative action. The public is often not aware of the existence of monopolistic practices.

Public utilities and common carriers usually carry on their business on a more or less monopolistic basis. The nature of the business is such that no other method would be practicable. Such businesses are subject to close government regulation. On the other hand, the government protects these concerns in their monopolistic privileges. A good example of this is a city transportation system. t would not be feasible to have two or more competing companies. Hence a monopoly right known as a *franchise* is granted. The company is then permitted by law to charge fares that will yield a reasonable return on the investment.

THERE ARE MANY UNFAIR TRADE PRACTICES

Since our legal institutions frown upon monopolies, it might be expected that they would favor any degree and any kind of compeition. Such is not the case. Certain kinds of competition may be as ruinous to our economic system as monopoly. If competition is dishonest, unfair, and completely unrestrained, it may do harm to honest enterprise, destroy profits, and thus discourage initiative and put a premium upon dishonesty and other unethical procedures. Another, and most serious, result of unfair and unrestricted competition is that it tends toward monopoly. When competition eaches a point where most of the competing units cannot survive, ome degree of monopoly may be the only escape.

Undesirable trade practices may take a variety of forms. Some of he outstanding ones are as follows:

1. Discrimination among buyers, including secret rebates
2. Dishonest advertising
3. Temporarily cutting certain prices below cost in order to eliminate competitors
4. Taking advantage of needy workers, thus making competition difficult for those who wish to maintain fair labor standards
5. Fraud in the issuance of securities to the public

The legal remedies for some of these practices will be discussed in the next chapter.

LABOR AND THE PUBLIC IN GENERAL MAY BE AT A DISADVANTAGE

Most of the other defects of our system enumerated at the beginning of this chapter directly concern labor and the general public. Most of these undesirable situations may be mitigated or eliminated by law or by the concerted action of business itself.

Inequality of bargaining power has its chief manifestation in connection with the employer-employee relationship. There is no equality of bargaining power between a lone laborer and a powerful corporation. The corporation can well get along without that particular laborer. For the laborer it is often a matter of life or death to get the job. On the other hand, if a great number of laborers unite for a common demand, the bargaining situation is somewhat equalized.

Most individuals lack the ability or the foresight or both to make proper provisions for contingencies or for old age. Great efforts have been made in recent years to overcome this defect by various provisions regarding *social security*. It is hoped that the day will come when no one ever needs to fear the specter of total destitution.

We have frequently been reminded how our competitive system, in general, tends toward socially useful ends. Unfortunately there are instances when wealth may be accumulated more quickly by antisocial methods. These should be eliminated. Closely related to this is the question of the inequitable distribution of wealth. Under our economic system inequality of wealth and income is desirable and essential, but there is a great difference between *inequality* and *inequity*. Accumulation of large fortunes should be countenanced only to the extent that it does not interfere with the public good. Beyond this point excessive incomes are nothing but a tax upon society.

To what extent the concentration of wealth is a serious social and economic problem is debatable. However, excessive centralization is at least a potential evil that well warrants careful investigation and thought.

SUMMARY

Besides the prevalence of business depressions there are many defects in our system, most of which can be mitigated or completely eliminated. Monopolies, unfair trade practices, inequality in bargaining power, lack of financial security, inequitable distribution of wealth, and in general the failure of business to work toward socially desirable ends are some of the chief evils that exist.

Monopoly is one of the most basic evils since it strikes at the very root of our competitive system. Although partial monopolies do exist, they usually have certain limitations. In addition to legal restrictions, monopolies are inherently difficult to maintain. This is not so true of railroads and public utilities, since they are considered *legal* monopolies and are regulated by the government.

On the other extreme we have certain unfair, dishonest, and otherwise undesirable forms of competition. These may consist of discriminations, dishonest advertising, unfair price-cutting, taking advantage of the unfortunate, and fraud in the issuance of corporation securities.

QUESTIONS FOR REVIEW

1. Besides the recurrence of the business-cycle phases, indicate six other basic outcomes of our present system that are undesirable.
2. Why is monopoly not to be desired in our economic system?
3. Indicate the main reasons why monopolies are difficult to maintain.
4. Why is it that it is impossible to have a complete and unrestrained monopoly?
5. Of what significance is the fact that a contract creating a monopoly cannot be enforced?
6. A public utility usually is a monopoly; yet we do not complain. Why?
7. Since we do not want monopolies, why is it that we object to certain kinds of competition?
8. Name some of the more undesirable trade practices found from time to time.
9. In what way does inequality of bargaining power frequently appear?

10. Explain the difference between *inequality* and *inequity* in distribution of wealth and income.

QUESTIONS FOR DISCUSSION

1. Is it possible that a monopoly may actually be beneficial to society?
2. If a particular company were to secure an absolute monopoly of some particular commodity, do you think it would likely raise the price of that commodity? Is there any possibility that it might lower the price?
3. What are some illustrations of dishonest advertising? Is there any difference of opinion as to whether or not some advertisements are of a dishonest nature?
4. If most laborers on a certain job are getting 60 cents per hour, is it unfair of an employer to hire a laborer at 40 cents per hour if he can get him for that rate?
5. Just why is inequality in wealth and income a desirable feature of our economic system?

CASE PROBLEM

The XYZ Company is a partnership composed of partners X, Y, and Z. These partners jointly own patent rights that assure them absolute control of the manufacturing of a concentrated food pill that, theoretically at least, would furnish a complete diet. Mr. X wants to put the pill on the market under a monopolistic price that promises great profit. Mr. Y fears that they may be prosecuted as a monopoly and doubts whether the product will sell. Mr. Z wonders just what the ultimate effect of this diet might be on the human body but thinks it would sell temporarily at least. They decide to try the experiment. What undesirable trade practices can you see likely to appear? If the business proves successful, do you think they can retain their monopoly?

SUGGESTED PROJECTS

1. Briefly report to the class on Federal antimonopoly laws in effect today.
2. Find out what is meant by Fair Trade Practices Conferences. By whom were they sponsored?
3. Report on one or more famous legal cases involving some well-known American firm and in which the question of monopoly was involved.

4. Report on some current or very recent legal action involving the question of monopoly or unfair trade practice.

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27. The umpire

PREVIEW: The interests and responsibilities of government and business are closely related. Business depends upon government for protection. Government also provides certain rules and regulations under which business operates. Developments in government-business relationships are of vital concern to businessmen and consumers. What are some of the government regulations that affect the actions of businessmen? Does business benefit by these regulations?

WHY REGULATION?

Not so long ago a common slogan in some quarters was, "What we need is more business in government and less government in business." It is still true that the government may regulate business to death. On the other hand, without regulation business may become more powerful than the government. Regulation is essential if business and the public are to prosper.

There is a difference between regulation and regimentation, although, when carried to extremes, regulation may become regimentation. Proper regulation permits private competitive business to function freely except in connection with instances when it clearly clashes with the public good. Regulation accepts competition as an instrumentality redounding to the public good. Regimentation is opposed to competition as such. Regulation, unless carried too far, still leaves us with the essential features of free enterprise. Regimentation, on the other hand, results in some form of a planned economy.

WHAT ARE THE REMEDIES?

At this point it is well for the reader to turn back to Chapter 26 and review the defects that mar the functioning of our economic system. It will not be our purpose to discuss in detail the various proposed remedies. In fact some of the proposed solutions will not even be mentioned. We shall confine ourselves to the following topics:

1. Coping with monopolies
2. Prevention of unfair trade practices
3. Regulation of sale of securities
4. Miscellaneous state regulations
5. Protection of collective bargaining
6. Fair labor standards
7. Social security

The first four of these will be taken up in this chapter. The last three, applying chiefly to labor, will be discussed in Chapter 28.

MONOPOLIES ALWAYS FROWNED UPON

Except when granted by legislative acts, monopolies have always been looked upon with misgivings, and contracts in unreasonable restraint of trade have been regarded as unenforceable. It was not, however, until about fifty-five years ago that specific Federal laws were passed in this country to curb or prevent monopolies.

The first major piece of Federal legislation applicable to the problem was the Sherman Act of 1890. This act, while declaring monopolies to be criminal and illegal, had certain defects. The chief shortcomings were that it failed to define clearly what is meant by unfair competitive acts, and it provided no satisfactory means for preventing monopolies from coming into existence. These defects were remedied by the Clayton Act of 1914 and by the Robinson-Patman Act of 1937, which defined more clearly what commodities are subject to lawful and unlawful price discriminations.

The administration and enforcement of the regulations are largely exercised through the Federal Trade Commission created in 1914. This commission has the right to issue complaints concerning unfair trade practices. Some of the practices coming within its jurisdiction are price-cutting, misbranding, interference with competition, secret rebates, espionage, boycotting, disparagement of goods, use of misleading names, false advertising, and predatory practices in general.

Upon issuance of complaints, the commission may order a hearing requesting the one complained against to show cause why he should not desist from his practices. Violations of the act and noncompliance with orders issued by the commission subject the offender to fines and imprisonment. Under certain circumstances, appeals from the commission will be heard in the Federal Courts.

SOME UNFAIR TRADE PRACTICES

Some of the most important legislation relative to unfair trade practices have to do with price discriminations and the regulation of resale prices. Subject to certain qualification, the Clayton Act as amended by the Robinson-Patman Act forbids price discriminations of a nature that will substantially lessen competition or tend to create a monopoly. The law applies only to those people engaged in interstate commerce.

Under the common law a contract that had for its purpose the regulation of the resale price of a product was illegal and void. In other words a dealer could not be bound by a contract to resell a product at a stated price. Legislation has now been passed making such contracts legal under certain circumstances.

Certain states led the way in legalizing the fixing of resale prices. Such laws, however, had a limited application since they could not apply to transactions originating outside the state; *i.e.,* they could not be applied to transactions involving interstate commerce.

This defect was remedied in 1937 by a Federal statute known as the *Miller-Tydings Act.* This law has three main points:

1. It attempts to bring the Federal law into conformity with states that have passed fair-trade acts.
2. It permits fixing of resale prices on commodities that bear the trade-mark, brand, or label of the manufacturer, producer, or distributor.

3. It does not permit price-maintenance agreements between competitors.

It may appear that the Miller-Tydings Act favors practices that tend toward monopoly. Those responsible for this legislation claim that it does not create monopolistic practices. In the first place, they say that it does not favor price maintenance among competitors, and the only price that is fixed is the resale price. Furthermore price-maintenance agreements are enforceable only in cases where competition exists in spite of such agreements. It will be noted that price-fixing is possible only when the article "bears the trademark, brand, or label of the producer or distributor." This means that other brands of the same commodity will usually provide effective competition and will prevent the fixing of an exorbitant price.

By way of illustration, let us take a commodity that we shall call *Tasty Toothpaste.* Dealers agree not to sell this for less than 50 cents a tube. This cannot create a monopoly, since you are free to buy other good toothpaste if you think the price is too high. It is also true that if other equally good toothpaste is widely sold at 39 cents, the price of the regulated commodity will eventually have to come down to close to that figure in order to be sold at all.

ANOTHER VIEW OF FAIR-TRADE LEGISLATION

Those who stand to gain from so-called "fair-trade" laws contend that price-fixing by manufacturers will not result in a combination to restrain competition. However, the consumer observes such practices with suspicion. The consumer looks upon free and open competition, where the retailer buys from the wholesaler or manufacturer at the best price he can and resells for what he can get, as one of the best means of protecting him from high prices. One retailer, more efficient and aggressive than another, may offset low profit margins by means of greater volume.

Resale maintenance laws are hardly passed for the benefit of consumers. To legalize price-fixing, as opposed to free competition, tends to guarantee profits to the inefficient retailers. Surveys to determine the effect of fair-trade laws upon retail price show that the consumer pays considerably higher prices after the passage of such laws. Stifled competition is not usually, according to consumer groups, consistent with their best interests.

CERTAIN LAWS PROTECT INVESTORS

There was a time when there was no protection against sale of fraudulent and worthless investments except such as was afforded by the general rules governing fraud. In 1911 Kansas took the lead in passing laws designed to protect more or less gullible investors. Since then nearly all the states have passed various laws having such a purpose in mind. These regulations are popularly referred to as *blue-sky laws.*

These laws vary so much in the different states that it would be impossible to make a generalization covering all. The following are some of the common types of regulations:

1. In a very few states the legislation merely permits the attorney general to take proper steps to secure an injunction restraining any party from employing fradulent devices or false representations in connection with the purchase or sale of securities.
2. Most of the other states go so far as to attempt absolutely to prevent the sale of fraudulent or questionable securities. In such states all dealers in securities must register with the state, pay a license fee, and comply with certain regulations. In many of these states permission must be obtained before any particular securities may be sold.
3. Some states, in addition to the requirements mentioned above, forbid the issuance of any securities whatever unless these securities fulfill certain specific requirements with respect to the assets, earning power, etc., of the issuing company.

The blue-sky laws have done much good, but there have also been unfortunate instances when they have failed to serve their laudable purposes effectively. It has been claimed that in a few instances they have gone too far the other way and have prevented the issuing of some legitimate securities.

A FEDERAL ACT WAS PASSED IN 1933

A serious defect of the state blue-sky laws is that they can cover only intrastate business. Furthermore these laws were sometimes ineffective even within a given state and were frequently poorly enforced. All this gave rise to a demand for Federal legislation.

The Securities Act of 1933, somewhat amended by portions of the Securities Exchange Act of 1934, was the answer to this demand. This act applies to all securities sold in interstate commerce or carried through the mails.

The Securities Act is often called the *Truth in Securities Act.* The Securities and Exchange Commission, which administers the act, is not expected to pass upon the investment qualities of a particular issue. The duty of the commission is rather that of enforcing truthful publicity with respect to the values back of each issue. Before any securities can be issued, complete information must be filed with the commission concerning all points in which the prospective investor might be interested. The prospectus and advertising material sent to all probable buyers must contain truthful statements of the essence of the information filed with the commission.

Punishment for willful violation of the act may be very severe. The penalty is as high as a $5,000 fine, 5 years in prison, or both. The purchaser of securities from a violating company may get a refund of the full purchase price by returning the securities. If he no longer owns the securities, he may recover damages.

STATE REGULATORY LAWS ARE NUMEROUS

In concluding the regulatory laws discussed in this chapter, we shall make mention of a few miscellaneous provisions, not already discussed, common to nearly all the state laws. Some of the most important are as follows:

1. Requirements for beginning a business. Examples are the creation of corporations and certain types of partnerships.
2. Requirements with respect to locations. This includes zoning ordinances and other similar regulations.

3. Requirements regulating advertising and the marketing of products.
4. Requirements as to licensing.
5. Requirements in connection with the operation of the plant. This refers chiefly to labor legislation, and this will be discussed in Chapter 28.

Most of these laws are based on the theory that legislation must intervene whenever competition would not produce socially desirable results. In connection with matters pertaining to interstate commerce, similar laws have been introduced through Federal enactment.

SUMMARY

In Chapter 26 we pointed out a few of the defects of the otherwise smoothly operating competitive system. In this chapter we have given a brief review of some of the remedies. The points covered were monopolies, unfair trade practices, regulation of the sale of securities, and certain miscellaneous state regulations.

QUESTIONS FOR REVIEW

1. What has the attitude of the law always been toward monopolies and toward contracts in unreasonable restraint of trade?
2. When was the Sherman Act passed? In general, what was its purpose? What two defects did it have?
3. When and why was the Clayton Act passed?
4. When was the Robinson-Patman Act passed, and what was its purpose? Give some examples of unfair trade practices regulated by it.
5. What are "cease and desist" orders? What happens if they are violated?
6. What seems to be the law regarding contracts to regulate the resale price of goods?
7. Explain the purpose of the Miller-Tydings Act.
8. Do consumer groups favor price-fixing?
9. What is meant by blue-sky laws? Why were they not very effective?
10. Explain the general purposes of the two Federal laws passed in 1933 and 1934 to regulate the sale of securities.

TERMS AND PHRASES TO DEFINE OR EXPLAIN

1. Interstate commerce
2. Sherman Act
3. Securities Act
4. Boycotting
5. Clayton Act
6. Misbranding
7. Blue-sky laws
8. Federal Trade Commission
9. Resale price maintenance
10. Cease and desist orders
11. Miller-Tydings Act
12. Securities Exchange Act
13. Robinson-Patman Act
14. Secret rebates

QUESTIONS FOR DISCUSSION

1. Differentiate between regulation and regimentation.
2. Why should society object to price-cutting?
3. How can you justify a law that upholds the fixing of resale price for an article?
4. Why is it that the Securities and Exchange Commission does not attempt to pass upon the relative values of securities?
5. Do you think the policy of requiring everyone who plans on starting a business to give evidence of ability to run the business would be worth considering?

CASE PROBLEMS

The Wholesale Food Company produces the "Tendergreen" brand of canned beans. Its competitor, the Consumers Food Company, produces a very similar quality canned beans known as the "Nature's Best" brand. Under the Miller-Tydings Act each company is permitted to control the resale price of its product. Since the two are so extremely similar in quality, the managers of these two companies feel that they should sell at the same price to consumers and so they agree on a resale price of 17 cents per can. Have they violated the law in thus agreeing to set the price at 17 cents? Explain the reason for your answer.

SUGGESTED PROJECTS

1. Consult some drugstore proprietor and ask him to mention some specific articles he stocks having the resale price controlled under the Miller-Tydings Act.
2. Report to the class on the purposes and activities of the Better Business Bureaus.

3. Report to the class on the origin and purposes of Trade Practices Conferences.

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28. Employer-employee relationships

PREVIEW: The problems of labor represent an important social and economic responsibility of the greatest significance. A sound program of employee-employer relationship is important for the smooth functioning of a free-enterprise system. Why do workers join unions? Are all unions the same? What has government done to improve employer-employee relationships?

THE GREATEST GOOD TO THE GREATEST NUMBER

In a democracy like ours we are committed to the idea of the greatest good to the greatest number. On this basis the laborers should be entitled to much consideration, since they constitute the overwhelming majority of the population.

If we include under the heading of labor all people who gain their chief income from working for others, this group represents about 75 per cent of the total money-earning population. Many others have economic interests somewhat directly tied up with labor. It is safe to say that whatever is good for labor is good in a direct way for at least 80 per cent of the population. Most of the others profit indirectly from a reasonable degree of prosperity on the part of labor.

WHAT IS GOOD FOR LABOR?

The conclusion might be drawn from the preceding statements that all we need to do is to improve working conditions, shorten the working hours, increase wages, and, on the whole, create a workers' paradise, and all will be well.

As a matter of fact the proposition is not quite so simple as that. In the chapter dealing with distribution of income (Chapter 25) we learned that there is a limit beyond which wages cannot go. This limit is first of all fixed by the amount of production. If laborers received everything, they still could not get more than the total production. Furthermore a reasonable share must always go to those who furnish capital, manage the businesses, and take the risks incidental to enterprise. If these shares were not forthcoming, enterprise would soon cease to exist, and laborers would find themselves without jobs. It is proper for laborers to seek their own welfare. It is a fatal mistake when the demands of labor are so excessive that they choke the very source from which their welfare flows.

THE DISADVANTAGES OF LABORERS

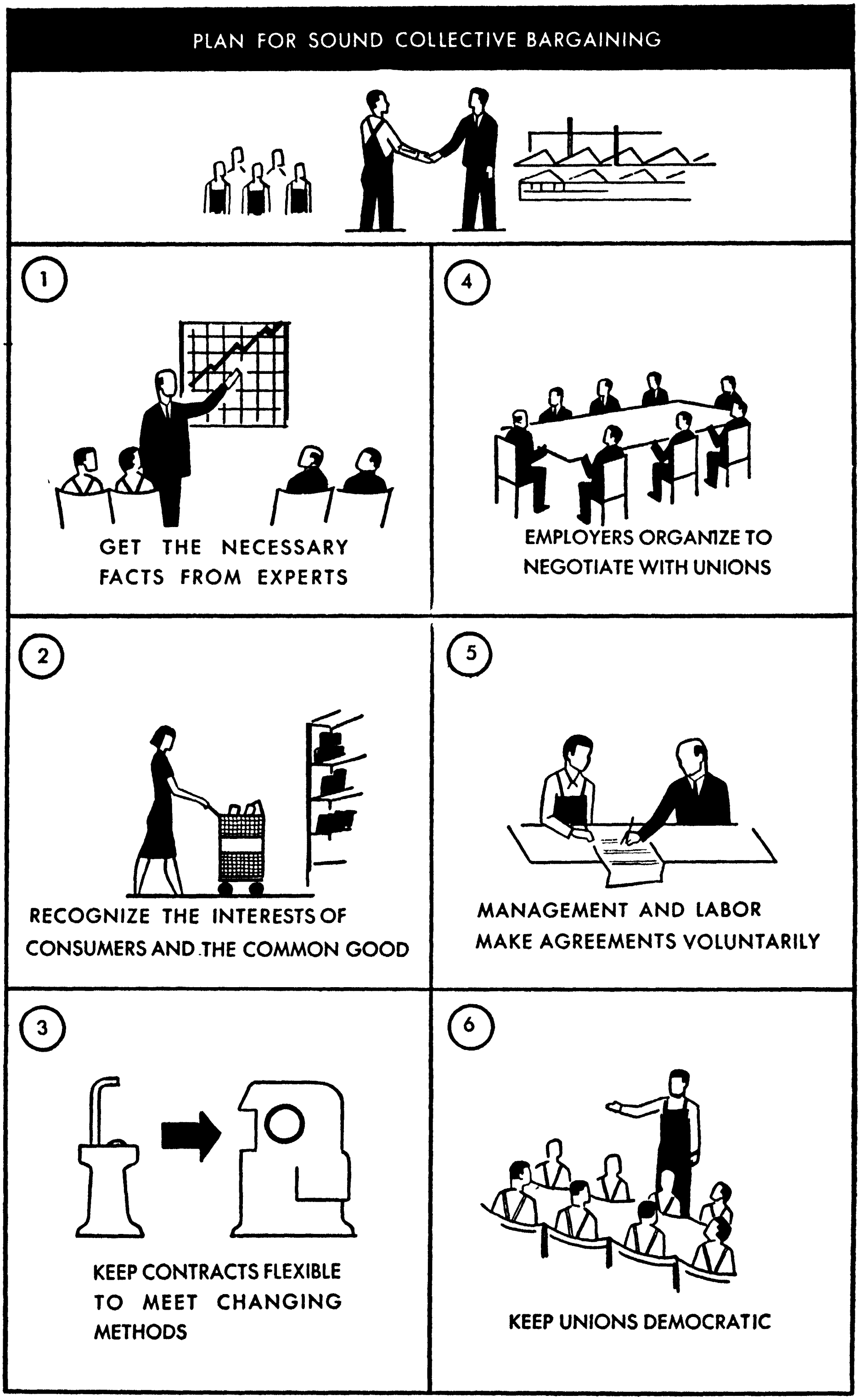
In the absence of legislation or effective concerted action, labor suffers from at least the three following disadvantages:

1. Inequality in bargaining power
2. Inability to prevent exploitation by certain unscrupulous employers
3. Lack of sufficient protection against results of accidents, unemployment, and destitution in old age

The remainder of this chapter will deal with efforts directed toward the mitigation or elimination of these handicaps.

BARGAINING IS STRENGTHENED BY COLLECTIVE ACTION

A semiskilled laborer with a wife and three small children has had no employment for 3 months. The purse is empty and the cupboard is bare. He goes to a prospective employer, normally employing 1,000 similar workers, and asks for a job. To the employer it is a matter of indifference whether he hires this particular man or any one of hundreds of others who are seeking the job. To the worker it is a matter of life or death to get employment. Under those circumstances it is easy to see who is in the position to dictate the terms of employment.


PLAN FOR SOUND COLLECTIVE BARGAINING
1
GET THE NECESSARY FACTS FROM EXPERTS
4
EMPLOYERS ORGANIZE TO NEGOTIATE WITH UNIONS
2
RECOGNIZE THE INTERESTS OF CONSUMERS AND THE COMMON GOOD
5
MANAGEMENT AND LABOR MAKE AGREEMENTS VOLUNTARILY
3
KEEP CONTRACTS FLEXIBLE TO MEET CHANGING METHODS
6
KEEP UNIONS DEMOCRATIC

(Data taken from "Trends in Collective Bargaining: A Summary of Recent Experience," published by the Twentieth Century Fund, 1945.)

Now let us suppose that a considerable number of workers in similar employment agree that they will not act as individuals but will bargain only as a group and will refuse to work for anything less than reasonable wages. In this case the employer is compelled to listen with a certain degree of respect. If he does not at least approximately meet the demands, he may find himself short of the needed number of workers. This is known as *collective bargaining.*

Certain groups of workers may carry this procedure further and enforce what is known as a *closed shop.* Under this arrangement the employer agrees not to employ anyone who is not a member of a union, and all bargaining is carried on with the union as such rather than with individuals.

THERE ARE VARIOUS KINDS OF LABOR ORGANIZATIONS

Labor unions have increased tremendously in membership and influence during the last 20 years. They fall into various types, chief among which are the following:

1. The craft union. This is the oldest type of labor organization. It consists of the unionization of certain trades regardless of where employed. Examples are carpenters' union, plumbers' union, welders' union, etc.
2. The industrial union. This type unionizes workers in particular industries regardless of kind of trade. For instance, there may be many particular trades within a given industry, but all workers in that particular industry belong to one union, such as the steel industry.
3. The general labor union. Various efforts have been made from time to time to unionize workers who may not be classified under any particular trade and who may shift among various kinds of industries. This applies especially to the large group of unclassified unskilled workers. Of all groups this is the most difficult one to organize effectively.

It has been found desirable to group the various labor unions into federations. The three outstanding of these are the American Federation of Labor, the Congress of Industrial Organizations (C.I.O.), and the Railway Brotherhoods. The A.F. of L. is the oldest organization, but the C.I.O. has made the most rapid progress in membership in recent years. The A.F. of L. is an example of the craft type of organization; the C.I.O. represents the industrial type. The Railway Brotherhoods, as the name indicates, are confined to employment in connection with railways.

THE NATIONAL LABOR RELATIONS ACT FACILITATES UNIONIZATION

There was a time when labor organizations were not held in very high esteem. It was deemed that they interfered with the freedom of individuals and at times tended to be monopolistic. At best they were merely tolerated. They were not encouraged.

ORGANIZED LABOR: A GROWING FACTOR IN U.S. LIFE

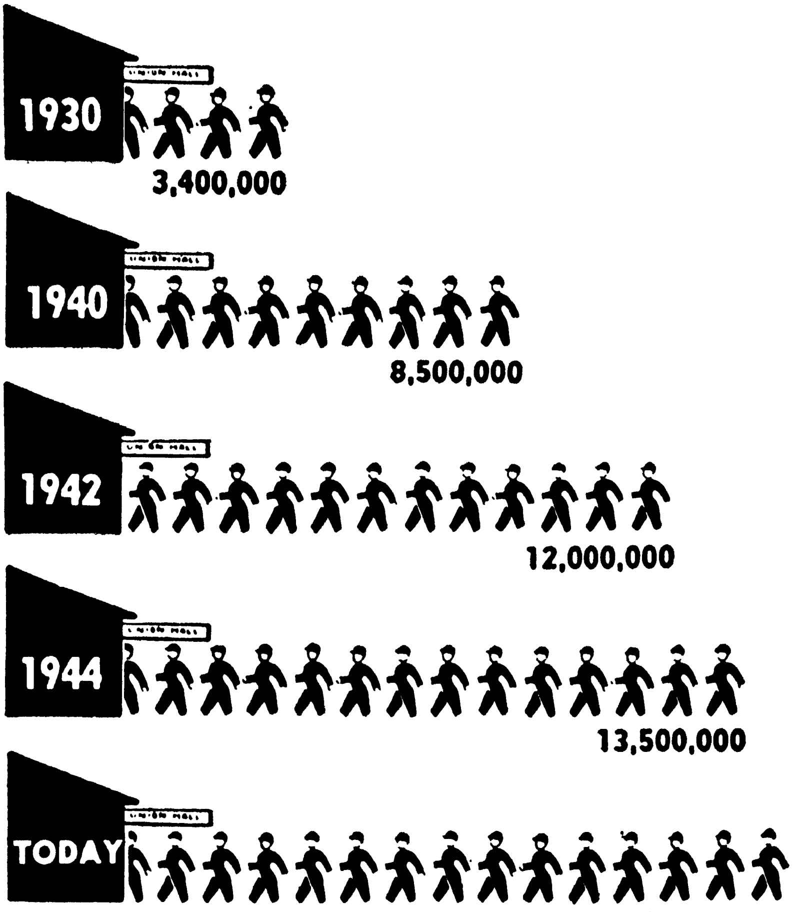


CHART BY GRAPHICS INSTITUTE, N.Y.C.

In 1935 a Federal law was passed marking a tremendous advance in the encouragement of collective bargaining. This was the National Labor Relations Act. The main provisions of this law are as follows:

1. Workers are given the undisputed right to organize unions and to bargain collectively with employers.
2. It forbids interference with labor organizations and discriminations against members of such organizations.
3. It provides that representatives elected by a secret vote of a majority of the employees shall be the exclusive spokesman for all the employees. This prevents the employer from insisting upon dealings with what is known as a *company union* —a union fostered by the employer himself.
4. It creates a National Labor Relations Board. This Board is authorized to carry out the provisions of the National Labor Relations Act, to pass judgment upon alleged unfair labor practices, and to issue orders to employers to desist from such practices.

THE TAFT-HARTLEY ACT

In 1947 the requirements under the National Labor Relations Act were somewhat modified by the passing of the Taft-Hartley Act. This law makes the following important provisions:

1. Sixty days' notice must be given before a strike can be called.
2. Unions may be sued for breach of contract.
3. Employers may talk to workers about unions, so long as neither threats nor rewards are involved.
4. Unions are required to account for their funds.
5. Communists are forbidden to hold office in unions.
6. Contributions to Federal political campaigns are forbidden.
7. Checkoff of union dues is allowed only if the worker agrees in writing.
8. No union shop is permitted until the majority of the workers approve it.
9. The closed shop is outlawed.
10. In vital industries, the government may get a court order to

prevent strikes for several months while strike settlements are attempted.

SOME PROFIT FROM MISFORTUNE OF OTHERS

Most modern employers believe in a policy of good working conditions and reasonable wages and hours. There are, however, always some persons who attempt to profit from the helpless conditions of others. When this is done it may start a vicious circle of exploitation of workers. If a few take advantage of a given situation, others may have to follow in order to remain in business at all. It has therefore happened that in certain lines of work practically all the employees have been scandalously underpaid.

It was to remedy this situation that the Fair Labor Standards Act of 1938 was passed. This law provides what is known as a *floor* for wages and a *ceiling* for hours. The law does not attempt to lay down any specific amount of "fair pay" for particular kinds of work, but it does provide a minimum below which wages (with some exceptions) cannot go. It also provides for increased pay, usually 50 per cent more, for time worked beyond 40 hours a week.

Certain workers, for instance, farm laborers, are excluded from the benefits of this act. Also, since it is a Federal law, it has application only to workers employed by persons who, to some extent, engage in interstate commerce. Recent judicial decisions have greatly broadened the scope of what may be construed as interstate commerce.

COLLECTION OF DAMAGES FACILITATED

Even under the old common law an employer at times had certain responsibilities if an employee was injured in the course of his employment and by reason of his employment. However, an employer had generally fulfilled his duty if he provided a place of work that was as safe as the normal hazards of the occupation would justify. Usually a worker could not collect if he himself or a fellow employee contributed to the injury. Even if the worker did establish a good claim, he still faced the possibility of an expensive law suit when he attempted to collect.

These defects have now been largely remedied in most states through the workmen's compensation laws. These laws provide that prompt payment of partial indemnity must be made by the employer in case of the death or disability of an employee resulting from certain accidental injuries. The indemnity must be paid regardless of fault, unless the injury is due to the willful act or intoxication of the employee. The only other important limitation is that the injury must *arise out of the employment and in the course of the employment.* To further facilitate prompt payment the employer is required to carry adequate insurance unless he can furnish proof that he is amply prepared, financially, to pay the sums for which he may become liable.

UNEMPLOYMENT A SERIOUS POSSIBILITY

No one has yet been able to present a workable plan for the complete elimination of unemployment. Unemployment over a short period of time may arise from local, seasonal, and technological reasons even under the best general conditions. Business depressions may bring on a veritable epidemic of unemployment. Although we cannot wholly eliminate unemployment, we can do something to mitigate the financial condition of those who are employed. This is at least partly accomplished through unemployment compensation laws. In brief this plan operates as follows:

Every employer of eight or more persons (except employers of the exempted classes) must pay a Federal tax on his pay rolls. This tax began at 1 per cent a year in 1936 and increased at 1 per cent a year until the maximum of 3 per cent was reached in 1938. Credit for amounts paid by the employer for *state* unemployment compensation may be taken up to 90 per cent of the Federal tax.

The rules for the payment of unemployment benefits are set up by the states, subject to requirements necessary for obtaining Federal aid. The usual compensation to the unemployed is one-half his weekly wage rate, subject to a certain maximum and minimum amount. The compensation continues for only a designated length of time, and the beneficiary must always be ready and willing to accept such reasonably suitable work as is offered to him.

The state laws require the employer to make contributions based on his pay roll. In some states the tax upon a particular employer varies somewhat in accordance with how much unemployment compensation his employees receive—the more the compensation, the higher the tax. The purpose of this is to encourage voluntary steps for providing constancy of employment.

LOOKING FORWARD TO OLD AGE

Although the poorhouse has never been quite the end of the road for most of the aged people, something not much less distressing has faced a majority of persons upon reaching retirement age. To guard against such an unfortunate ending of a person's span of life was the chief purpose of the Social Security Act of 1935.

The operation of this law is financed through a pay-roll deduction matched in an equal amount by a tax on the employer. The amount paid in by each employee, increased by an equal amount provided by the employer, accumulates at compound interest in favor of the employee till he reaches the age of sixty-five. After that time he receives a lifetime annuity based upon the accumulations credited to his account.

Many workers do not come under the provisions of the Social Security Act. The most important of these are agricultural, domestic, ship, governmental, and charitable-organization employees. Employees of railroads, express companies, and sleeping car companies do not come under the act, but a similar purpose is served by the Federal Railroad Retirement Act of 1937.

THEN THERE ARE GENERAL OLD-AGE PENSIONS

Exclusion from social security benefits does not bar a person from some relief in old age. Most states provide some help to any needy aged person who meets certain specified requirements as to citizenship, state residence, etc., and who is not an inmate of an institution subject to institutional care. The required age is usually sixty-five, and the amount of assistance varies in the different states. Old-age benefits of this type are paid only to persons who prove that they actually need the money in order to live. A person who has complied with the requirements under the Social Security Act receives the resultant benefits regardless of his economic status.

SUMMARY

The welfare of laborers is important from a social standpoint, since they constitute more than 75 per cent of the total population. In seeking the welfare of labor we must look to the long-range benefits rather than to such things as are advantageous merely for the moment.

The welfare of labor may be promoted by improving its bargaining power, by preventing exploitation by unscrupulous employers, and by providing a greater measure of financial security. The first of these objectives is promoted by the creation of the National Labor Relations Board. The Fair Labor Standards Act attempts to mitigate various forms of labor exploitation. Unemployment and old-age benefits are provided through the Social Security Act. Most states have also passed workmen's compensation laws that go far toward guaranteeing workers reasonable indemnification if injured while engaged at their employment and because of their employment.

QUESTIONS FOR REVIEW

1. To what extent are we all interested in assisting labor?
2. Why is it that higher salaries and shorter working hours may not be best for labor?
3. What three natural disadvantages does a laborer seem to have?
4. What is the purpose of collective bargaining?
5. What is the closed shop?
6. Identify and briefly describe each of the three main types of labor organizations.
7. Identify the three main federations of labor unions.
8. What were the main features of the National Labor Relations Act of 1935?
9. How do workmen's compensation laws facilitate the collection of "damages"?
10. What are some of the causes of unemployment?

11. What provision has the Federal government made for assisting the laborer to meet periods of unemployment?
12. What, in general, are the features of the Social Security Act of 1935?
13. Is there any provision for taking care of needy people during old age other than that provided under the Social Security Act of 1935?

TERMS AND PHRASES TO DEFINE OR EXPLAIN

1. Collective bargaining
2. Craft union
3. A.F. of L.
4. NLRA
5. Social Security Act
6. Closed shop
7. Industrial union
8. C.I.O.
9. NLRB
10. Workmen's compensation law
11. Company union
12. General labor unions
13. Railway Brotherhoods
14. Federal pay-roll tax
15. Pay-roll deduction
16. Taft-Hartley Act

QUESTIONS FOR DISCUSSION

1. Should the cost of providing social security for the workers be included as a part of the price the consumer pays for goods he buys?
2. If the demands of labor unions for higher wages, shorter hours, etc., become too excessive, what may the result be?
3. From the standpoint of society in general, do you think the closed shop is desirable?
4. Can you see any real justification for excluding certain groups of workers from the benefits of the Social Security Act? Why was it done?
5. Can you see any real disadvantage or danger in further extension of the policies represented by our Social Security Act?

CASE PROBLEM

Experience seems to show that many employees of the Baering Manufacturing Company do not have sufficient savings to retire during old age. One executive of the company advocates paying higher wages. Another advocates setting up an old-age retirement annuity. Still another advocates giving employees free advice and assistance in problems of consumer spending, saving, and investing. Which executive do you think probably shows the soundest judgment?

SUGGESTED PROJECTS

1. Find out and report to the class on the amount that employers must deduct from pay-roll checks for social security payments, including unemployment insurance and old-age pension. In addition, how much must the employer pay?
2. What, in general, is the difference between the A.F. of L. and the C.I.O.?
3. Briefly report to the class on some of the current activities, interests, or decisions of the National Labor Relations Board.
4. Investigate and report on the provisions of your own state relating to (*a*) minimum wages for teachers and (*b*) retirement or old-age pensions for teachers.
5. Investigate and report on magazines and bulletins in your library dealing with labor, labor statistics, labor problems, etc. What type of information does each carry? How often is it published?

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29. Business ethics

PREVIEW: Everything cannot be accomplished through law. As a matter of fact it is desirable that legislation should be introduced only when other methods fail. A fair and enlightened attitude on the part of everybody concerned is the best assurance that business will be directed toward socially desirable ends. Furthermore, if such an attitude is lacking, the best of laws are often doomed to failure. The question of what is right or what is wrong in any given situation is called *ethics.* When applied to business, this is called *business ethics.* What are businessmen doing to improve business ethics?

LAW SERVES A USEFUL BUSINESS PURPOSE

While pointing out the efficacy of the competitive system, we have not neglected to point out the many difficulties that arise in connection with the operation of this system. It is here that the law steps in to regulate, restrain, or encourage, as the case may be. Some of these laws have to do chiefly with transactions carried out among individuals. Other laws aim at broad regulation of particular businesses or of the commercial community in general.

It is a fact recognized by both the legislators and the courts that there is a limit to the extent to which laws can cure our social and economic ills. There is some truth to the saying that "You cannot make people *good* by legislation." If we should attempt to remedy all undesirable conduct by law, our courts would be totally incapable of coping with the situation. Furthermore it would in many cases tend to restrict personal freedom unduly and would create disrespect for all laws. Finally there is a considerable difference of opinion in some cases as to what really *is* right and wrong. In such cases it is best to leave the matter to each individual's discretion, and to the rather restraining influence of public opinion.

KEEPING WITHIN THE LAW NOT ALWAYS ENOUGH

There are those who are scrupulous in their observation of the specific rules of law. On the other hand they may be scoundrels in all matters not definitely covered by law. They keep within the law, but they always go as far as the law allows.

Many people follow this principle to a greater or less degree. This is not only an immoral practice, but in the long run it is a poor business policy. Permanent success in business must be built on a higher type of virtue than just "keeping within the law."

ETHICS: A BROAD CONCEPT

Since this book is neither a treatise on philosophy nor on religion, we shall not attempt to explore all the concepts back of what we term good and bad, right and wrong, virtuous and immoral. Questions relating to desirable and undesirable human behavior come largely under a field of study known as *ethics*. We may therefore say that ethics is the study of right and wrong.

Some people ridicule the idea of business ethics as a separate study. With some show of logic they ask if the brand of ethics practiced by businessmen should be different from that followed by other good people. The answer is that in general it should not. However, in dealing with ethics with respect to business we are treating a *specialized* application of ethical principles that can best be covered by separate treatment. The present literature on business ethics is quite voluminous and constitutes an instructive and highly interesting field.

Why should a businessman be ethical? There are several reasons. In the first place it is usually a good business policy. For instance, it is still true that honesty is the best policy. A person may gain some temporary advantage through dishonesty or other unethical practices. In the long run, however, he is the chief loser. People will not continue to trade with a person who has acquired a reputation for shady dealings.

But business ethics must be based on firmer ground than mere business expediency. Honesty is a good policy, but honesty based on nothing but policy is a poor type of honesty. The businessman is a human being and as such has certain responsibilities toward society. The best kind of businessman will be sensitive to the approval or reproach of society even if his success in a monetary way is unaffected. An ethical person will not take advantage of every available legislative loophole that gives him a chance to escape his obligations. Thus a person may eventually be cleared of his debt by the mere lapse of time. An honest debtor will not take advantage of this situation but will pay the debt, if he can, even if it is outlawed. "There is no statute of limitations between gentlemen."

There are many instances of this nature—instances when a person could profit greatly by taking full advantage of legal technicalities, or the other person's inability to do anything about it. The following are a few examples gathered at random:

1. Insistence upon immediate fulfillment of a contract when a brief postponement would save the other party much hardship.
2. Taking undue advantage of another person's distress to drive a hard bargain.
3. Failing to live up to an honest obligation because of a purely technical defect in a written instrument.
4. Taking advantage of another person's lack of written evidence when one knows exactly what the obligation is.
5. Promising a person the first chance at buying a certain piece of property and then selling the property to someone else. This can be done legally if the other party does not have an option. Such a procedure is legal, but it is not ethical.
6. Failure to settle a just claim because one knows that the other person is financially unable to bring suit.

SHOULD WE PROFIT FROM PEOPLE'S IGNORANCE?

Since "ignorance of the law excuses no one," many people feel free to take advantage of people's ignorance. The ethics of such a procedure is of a doubtful quality, to say the least. For instance, a smart person might buy a claim that the seller, for lack of legal knowledge, considers worthless. The buyer knows the claim is valuable and makes a huge profit. The buyer may console his conscience by the assertion that it served the seller right for being so ignorant, and yet we feel that it was not the right thing to do. This would certainly be the case if the seller asked the buyer for advice and was misinformed.

SHOULD THE BUYER BEWARE?

The old legal slogan of *caveat emptor,* let the buyer beware, still lingers on. However, the old idea that trickery and bargaining are almost synonymous terms has been largely abandoned. Gullibility may still result in disaster, but the buyer now has more protection from both a legal and an ethical standpoint.

As a matter of fact, we are gradually approaching the rule, "Let the seller beware." Satisfied customers are a great asset, and many businessmen will go to great lengths to secure them. For instance, the law does not compel a merchant to take back goods unless there is a breach of warranty. Nevertheless many merchants now take back any goods that the customer desires to return.

As a matter of fact we may wonder if the idea that "the customer is always right" has not been carried to extremes. When competition is keen, one dealer seeks to outdo the other in various customer courtesies. Some of the merchants may not like it, but they are compelled to follow along in order not to lose trade. Under such circumstances it is always ethical for the customer to take full advantage of the situation. We hear much about ethics of merchants toward customers. We sometimes wonder if this situation in reverse would not also deserve investigation.

BUSINESS ETHICS EXTENDS TO ALL

It is not sufficient for a businessman to be ethical toward his customers. He must also exercise fairness toward his business associates and competitors. The law, to some extent, protects business associates. This is covered in the laws relating to agency, partnerships, and corporations. There are, however, many loopholes and deficiencies in these laws, and a man often runs far short of his ethical obligations if conforming to the law is the limit of his endeavors.

Fairness to competitors is a principle of relatively recent development. Often a competitor used to be looked upon as a natural enemy. It was, figuratively, a fight to the death in hopes that the best man might win. This has now largely given way to the rule of let and let live. People still compete keenly. This is as it should be. However, there are certain "rules of the game," and a person who commits a "foul" suffers the proper penalties.

Business ethics has now been largely systematized. Laws have been passed to create better business relationships. Businessmen have voluntarily adopted codes governing their particular field of action. A businessman who fails to pay at least some attention to these rules of business conduct exposes himself to situations that may make it difficult for him to continue in business.

BETTER BUSINESS BUREAUS

One outstanding effort on the part of business to regulate its own conduct is represented by a national movement called the *Better Business Bureaus.* These bureaus represent an organized effort on the part of business aiming at the voluntary elimination of unfair, misleading, or fraudulent advertising and selling practices. The more specific aims are as follows:

1. Elimination of false and deceptive advertising
2. Promotion of ethical standards
3. Serving consumers impartially in their relation to business
4. Warning the public about deceptive schemes
5. Promoting better understanding of the mutual problems of business and consumers
6. Providing basic merchandising facts to consumers

The Better Business Bureaus operate nationally through the National Association of Better Business Bureaus, Inc. Affiliated with this national organization are some sixty local Better Business Bureaus located in the principal cities of the United States and Canada. Each bureau is an independent, nonprofit, locally governed and financed organization.

THE BETTER BUSINESS BUREAUS IN THE SECOND WORLD WAR

The Better Business Bureaus were especially active during the war. In addition to their usual functions they took effective action against rackets and frauds arising from wartime conditions. They helped to curb rackets that profited by taking advantage of people's patriotism, and fought wartime deceptions and black markets. Working in cooperation with the retailers, they assisted in the fight against inflation and helped to promote equitable distribution of merchandise.

SUMMARY

Law is good but not always adequate. Where laws governing business relationships end, business ethics begins. A person who is content with merely keeping within the law is not a high type of businessman. Ethics is based on more than expediency. It also embraces a broad concept of abstract justice and of social responsibility.

Ethics extends to all our business relationships. It embraces our customers, our associates, and even our competitors. Business ethics has made great strides in recent years. In fact it has now arrived at a degree of concreteness and definiteness that justifies us in referring to business ethics as a science.

This chapter concludes our over-all view of business. We began with the general nature and objectives of our economic system and followed this with a review of a few of the basic agencies that serve business. We then traced business through its inception, operation, and functions, after which we considered the place of government in its business relationships. Quite fittingly such a study should close with the question of elevating business to a higher plane—the topic of business ethics.

Throughout the study we have attempted to draw a realistic picture of business, intermingled with a slight touch of idealism. We have tried to present not only the din but also the heart throbs of business. We believe that the latter phase of the subject should not be ignored. We are prone to look upon business merely as a daily grind for sheer material gain. It is more than that. It is a part of the perpetual human struggle for a better world. It is a portion of the long upward trek where—in spite of errors, fumblings, sins, struggles, and wars—people, in their various ways, seek the higher planes inspired by the faint ray of hope that some day toiling humanity will at least catch a glimpse of the City of God.

QUESTIONS FOR REVIEW

1. Just what are the purposes of law as applied to business?
2. To what extent may public opinion adequately replace law?
3. Is one who is within the law necessarily ethical?
4. What is ethics, broadly speaking?
5. Why should a businessman be ethical?
6. Indicate some illustrative legal privileges that good ethics would indicate should be waived?
7. Is it ethical to profit from people's ignorance?
8. What seems to be the present practical status of the rule of *caveat emptor?*

QUESTIONS FOR DISCUSSION

1. Do most people feel that their favorite neighborhood grocer is ethical?
2. Many people seem to feel that big business is not completely ethical. Why do you suppose such feelings exist?
3. Would a larger per cent of unethical people be found in the business world than would be found within other occupational groups?
4. If all business people were completely ethical, what advantages would accrue to everyone?
5. Which is more unethical, gossiping about your associates or going back on a promise you made but which the law says is unenforceable?
6. Which is more unethical, asking students who have previously taken a certain course what questions were used in examinations, or hiring someone to spy on a competitor in business?
7. Which is more unethical, getting a grade to which you are not entitled or getting a higher price from a buyer than that to which you are entitled?

CASE PROBLEM

During wartime the Frankel Merchandise Company sold a small shipment of alarm clocks at a price of $1.29 each. The manufacturer had described the exact materials and workmanship used in the clocks but, owing to the uncertainties of war production, refused to guarantee them. Likewise, the Frankel Company had not guaranteed the clocks. The Frankel Company made a profit of only about 10 cents on each clock. One indignant customer demanded that the Frankel Company refund the price paid for the clock, claiming that after but 2 weeks' use it simply would not run. What should be done about it?

SUGGESTED PROJECTS

1. Obtain a copy of the code of ethics of one or more groups such as Rotary, Lions International, Kiwanis, teachers, lawyers, doctors, etc. If possible, have sufficient copies duplicated to give one to each member of the class.
2. Prepare a list of unethical practices of customers with which businessmen are frequently faced.

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